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Revenue Enhancement Group Report

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EXECUTIVE SUMMARY

The USAID-funded Georgia Enterprise Growth Initiative supported three public-private stakeholder groups in developing recommendations for improving excise tax collection from products in the petroleum, tobacco, and alcohol industries. The aim of this work was to both increase revenue collection and improve the competitive position of legitimate businesses in these industries.

The stakeholder groups estimate that the Georgian budget now loses at least \$265 million in excise tax revenues in these three industries, including:

- \$200 million loss in the petroleum industry,
- \$25 million loss in the tobacco industry,
- \$40 million loss in the alcoholic beverage industry.

Recommendations made by stakeholder groups to capture this lost revenue and improve the competitive position of legitimate businesses in these industries include:

Petroleum

- Form a high-level steering group to oversee rapid implementation of enforcement activity
- Set up a dedicated analytical center that can document market imbalances, identify potential violators, and recommend enforcement action
- Immediately cancel accreditation of unqualified testing laboratories
- Begin regular and random spot-check inspection of service stations, and require tamper-proof metering as a condition of licensing
- Impose mandatory reporting on informal refineries
- Monitor Georgian crude oil prices against world market prices and move the domestic crude oil market towards a transparent auction system
- Capture and compare railway loading/discharge information and information collected by border guards against other data sources to identify violations
- Impose minimum conditions on the licensing of petroleum traders and importers
- Require licensing of all petroleum terminals, including compounding plants

Tobacco

- Introduce licensing requirements for cigarette importers, manufacturers, and distributors
- Improve the current regime for returning damaged excise tax stamps
- Strengthen penalties on the sale of counterfeit goods
- Improve systems to allow wholesalers and retailers to ensure that they are sourcing legitimate supplies of tobacco products
- Create an analytical data center to support improved enforcement
- Implement an improved “track-and-trace” system for tobacco products to identify violators and allow wholesalers and retailers to verify that their supplies are legal
- Modify the excise tax structure to introduce predictability, maintain competitiveness, and reduce incentives for smuggling and counterfeit products

Alcohol

- Create an analytical data center to estimate reported and estimated production and inform subsequent enforcement mechanisms
- Replace Samtrest as the industry's main regulator
- Improve excise tax administration and strengthen penalties for violators
- Introduce a cargo tracing system for alcoholic beverages

1. INTRODUCTION

The Georgia Enterprise Growth Initiative (GEGI) project was tasked by USAID to “build capacity within the staff of the Oil and Gas Regulatory Agency to collect, reconcile and analyze petroleum production and import data” following a visit to Tbilisi by Deputy Assistant Secretary Pascoe. Building upon the earlier success of the AMCHAM Petroleum Advisory Group (PAG) in identifying an estimated \$200 million annual leakage in petroleum revenues, technical assistance was provided to the state agency to exercise its regulatory authority to help recover the \$18 to 20 million leakage in the refinery part of the petroleum market. In its nine weeks of work with the state agency, PAG identified the critical problems in the refinery sector and developed a step-by-step action plan for recovering all leakages. PAG presented this action plan to the Ministry of Finance in mid-February.

With the closure of 14 illegal refineries by the Ministry of Finance in mid-March, GEGI and USAID decided to re-deploy the PAG resources to the larger mission of recovering all the leakages in the three main excise good categories – petroleum, tobacco, and alcohol.

Total annual leakages are estimated at a minimum of \$265 million, with \$200 million from petroleum products, \$25 million from tobacco products, and another \$40 million from vodka alone. All GEGI-funded PAG resources were re-positioned with the GEGI Revenue Enhancement Group (REG) and dedicated to the mission of making all three industries legal and competitive, with all leakages returned to the state. REG’s approach to supporting enhanced revenue collection was tailored to each product group.

Petroleum products. REG provided follow-on support to the previous PAG work, including provision of analytical support by industry expert Dr. Bhamy Shenoy who analyzed excise tax collection problems and recommended improved enforcement strategies to address tax revenue leakages. REG also led three petroleum stakeholder meetings to promote private-public dialogue. Kakha Damentia, head of the Excise Tax Inspectorate of the Ministry of Finance, participated in all meetings. As a result of these public-private consultations, private sector petroleum companies seeking a legal market formed the Petroleum Importers Association, which held its first public conference on April 26, where the Association’s members publicly signed a code of ethics that commits all signatories to help stamp out smuggling. The petroleum-specific analysis and action plan whose development were supported by REG are included in Chapter 2 below.

Tobacco products. REG organized the first stakeholders meeting for tobacco companies committed to legal and competitive markets. ETI and stakeholders supplied REG with valuable data, information, and analysis related to anti-smuggling measures. REG then further supported the stakeholders with technical assistance from the Tobacco Merchants Association (TMA), which provided input to estimating tax revenues and leakages from the Georgian cigarette market and submitted key recommendations on introduction of more effective tax and enforcement policies. These recommendations are presented in Chapter 3 below.

Alcoholic beverages. REG also organized the first stakeholders meeting of alcohol companies committed to legal and competitive markets. These companies have begun to carry out initial revenue gap analysis work, which is presented in Chapter 4 below.

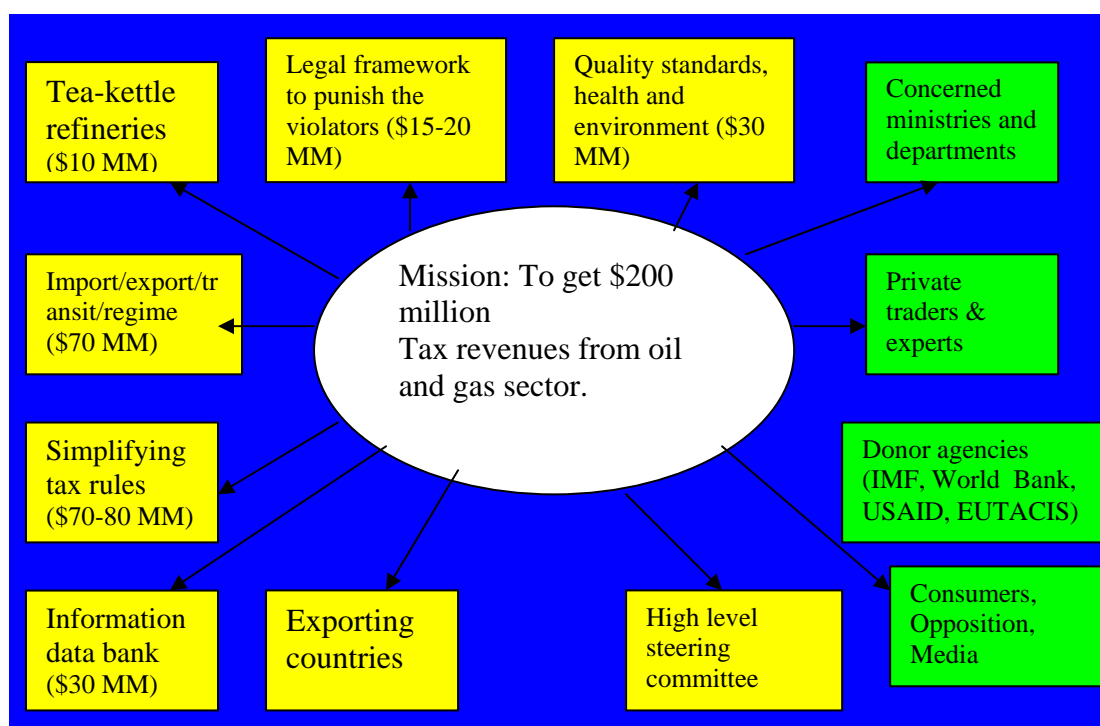
2. PETROLEUM PRODUCTS

With the assistance of REG experts, the petroleum sector stakeholders prepared the following analysis and recommendations, which build on earlier work prepared under PAG.

The stakeholders recommended the formation of a high-level steering group that should meet at least once every two weeks in the first six months to coordinate and monitor the progress of petroleum sector's revenue enhancing activities. The need for such a high level group arises out of the integrated nature of the petroleum sector and involvement of other (e.g. Standards, Railways, border guards, Ministry of Security). If possible, this group should be chaired by the Prime Minister.

The group's analysis regarding the size and nature of petroleum product revenue leakage is summarized in the following figure:

Figure 1: Summary of Petroleum Excise Tax Leakages



Because of the specific nature of the petroleum sector, it is not advisable to directly combine the revenue enhancing activities of this sector with those of tobacco and alcohol. While there are some similarities in terms of tax collection, challenges differ in terms of production (e.g. buyers of crude oil have to offer informal payments to secure crude supplies), refining (crude supplies are undocumented and can include theft from pipelines and rail cars or smuggled product from Chechnya, etc; refiners also sell naphtha for blending into low-quality gasoline and mazut for low-quality diesel), importation (transit fraud), and marketing (under-reported sales to evade VAT; gasoline, diesel, and even LPG is sold from roadsides).

An Analytical Center should be formed, reporting to the Minister of Finance. It should consist of highly qualified Georgian analysts who have a thorough understanding of the petroleum sector and are capable of initiating investigation as a result of their work. The analysts should have the capability to carry out complex analysis to detect ways of defrauding the government and to develop creative ways to fight them. This can act either under the direct control of the steering committee or the finance minister. The steering committee should then assign responsibilities to the following groups to implement time-bound enforcement initiatives and monitor the progress through the analytical center on a continuous basis.

Standard Regulatory Body (Sakstandarti)

1. To cancel accreditation of many of the testing labs which do not meet the minimum standard requirements. This should be done within one month. Only two labs appear to meet the requirement today.
2. To inspect petroleum products at service stations all over the country, and to ensure that it has the legal rights to initiate legal proceedings against the guilty parties (through legal changes, if necessary).

State Agency for Regulation of Oil and Gas Resources (SAROGR)

1. To obtain periodic reports on the product movement at refineries. SAROGR has previously asked licensed refineries to submit these reports on a monthly basis. This should be coordinated with the Excise Tax Inspectorate, which should be asked to investigate refineries not complying with SAROGR information requests.
2. To strengthen the inter-agency group established by SAROGR to issue and monitor refinery licensing procedures.
3. To institute a robust system to monitor the actual oil production by different oil companies.
4. To analyze crude prices for local Georgian crude oil production against the international price and identify discrepancies. Simultaneously, SAROGR should institute a transparent system for pricing crude oil. One initial step is to organize an auction market for at least Saknavtobi, the National Oil Company.

Railways

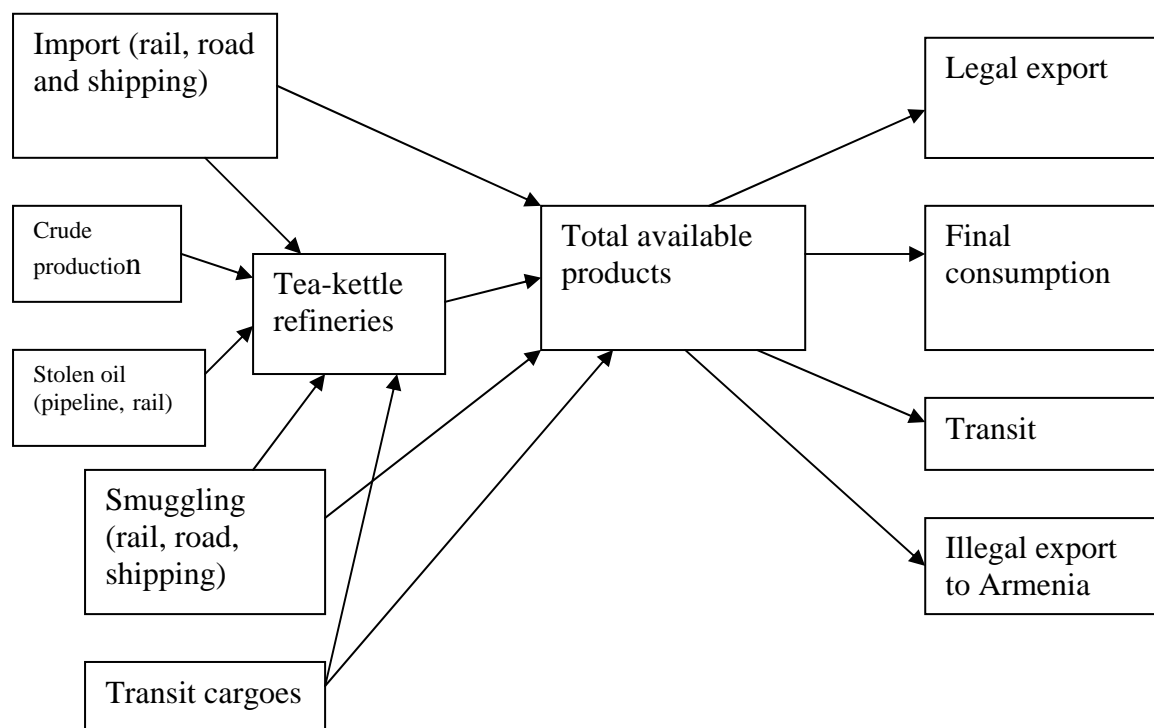
1. To develop a reporting format to secure daily data on petroleum product movement by railways, to be shared with the Analytical Center.
2. To improve transit procedures and security in conjunction with the customs department, perhaps including a GPS tracking system or other required technology.

Ministry of Security

1. Working with the Ministry of Finance to develop a robust system to secure information on the operations of the informal refineries.

Border Guards

1. To work with customs to closely monitor the movement of petroleum products at all borders not only from the point of view of reducing bureaucracy but also to detect any illegal trading.



The Analytical Center should collect and disseminate information on petroleum product supply/demand for Georgia. Today there is no reliable information base on the Georgian petroleum sector (see Appendix A which shows the kind of information that should be available to the center). The main areas where improved information is required to support enforcement activity include:

1. Oil and gas production. SAROGR collects information submitted by producers. But there is a considerable amount of doubt about the accuracy of these statistics. There is reason to believe that local crude oil production may be underestimated to the extent of 50 to 100 percent.
2. Petroleum consumption. Many attempts have been made to estimate Georgia's petroleum consumption, but none have relied on sound surveys. In the case of products such as gasoline, diesel, LPG, and kerosene, a market survey can be conducted using local market research talent. Legal imports of gasoline and diesel seem to be more than 50 percent below existing consumption estimates.
3. Information on informal refineries. To include address, ownership, capacity, product yield pattern, notional profitability, crude sources, product disposition, approximate investment etc. SAROGR is expected to develop this data, but has failed to do so far.
4. Information on service stations. To include address, ownership, source of products, sales, when licensed etc. It is not clear who is supposed to consolidate this information – the earlier

Excise Tax Monitoring Bureau was expected to produce this information, and the Excise Tax Inspectorate is now in the process of developing such a data bank.

5. Information on product terminals. To include address, ownership, throughput, products handled, date of licensing, etc.
6. Information on oil traders. To include address, sales, when and what kind of licensing.

The Analytical Center should then be able to calculate product supply/demand analyses on an annual basis and for major products such as gasoline, diesel and LPG on a monthly basis to help monitor smuggling and contraband operations. This relies on the assumption that:

$$\begin{aligned} \text{Georgian Product Consumption} = & \text{Local refinery production} + (\text{Import} - \text{export}) \\ & + \text{smuggling} + \text{transit cargoes diverted into local market} + \text{illegal operations of} \\ & \text{the refineries} + \text{blending of components.} \end{aligned}$$

The Analytical Center should also regularly obtain information from countries that export petroleum products to Georgia, and reconcile it against customs and tax records for their veracity to detect smuggling operations.

Monitoring Service Stations

1. By installing tamper proof meters, it should be possible to get a good record of sales of products from any service station. This is the system oil companies use for their own stations. In the case of owner-operated service stations, such a system should be required as a condition of licensing by the Ministry of Finance.
2. The Excise Tax Inspectorate (ETI) is planning a reporting system to monitor the sales of gasoline from each service station. While it is not advisable to get sales and purchase report on a daily basis, stations can be required to keep a daily report on sales, inventory and purchases. Through random inspection, it should be possible to find out if there is any under-reporting of sales. If there is a variation (e.g. more than 10 percent), the penalty imposed should represent a strong disincentive.
3. ETI should also receive a monthly report of sales, purchases (by source) and stock inventory from each station.
4. ETI should also receive from each trader information that can then be verified against other records. Any discrepancy will indicate illegal activity that ETI can then investigate.
5. Random sampling at service stations should be carried out.

Monitoring Traders and Importers

1. A licensing system for traders and importers should be adopted at the earliest to limit their number by the following minimum restrictions. They should meet the following requirements:
 - a. Capital of \$500,000 and
 - b. Owning or leasing 1000 cubic meters of storage for at least one year or
 - c. Owning at least five service stations.

2. ETI should require monthly reports on imports, sales and inventory, and a daily movement record for all products that can then be audited by authorities. As elsewhere, violators must face significant penalties.

Monitoring the Operations of Petroleum Terminals

1. A licensing system for terminals (including the so-called compounding plants) should be adopted. Today, compounding plants are licensed by SAROGR. In reality, a compounding plant is nothing but a terminaling operation, so the change may require amendments to the Petroleum Law.
2. Each terminal owner should maintain a proper register on the stock, purchases and sales of products. If they do not purchase and sell products, then the record should include the movement of products coming in and going out on a daily basis.

REVENUE ENHANCEMENT ACTION PLAN FOR OIL PRODUCTS

	Tasks	Primary responsibility	Secondary responsibility	Start date	Completion date	Deliverables	Remarks
	Management/Policy						
1	Forming a high level steering committee	Finance Ministry		ASP	Middle of June	A Presidential Decree	REG has already started this process
2	Forming an analytical center (AC)	Finance Ministry	REG to assist	ASP	End of June	A fully equipped office with at least three analysts	This is a critical step
3	Steering committee to order Standard regulation unit to organize a special cell to monitor implementation of product quality standards on a war footing	Steering Committee	REG to assist AC to monitor	ASP	Middle of June	A fully functioning cell	This cell may report to FM initially and also to Standard Regulation Unit
4	Steering committee to coordinate the activities of different departments in a mission mode and on a war footing with clearly established goals and timelines on a weekly basis	Steering Committee	REG to assist AC to monitor	ASP	June, 2005	To improve revenue collection in petroleum sector at least by \$200 million	
5	Steering committee to ensure reasonable level of salary structure to all personnel involved in waging war against corruption in petroleum sector	Analytical Center	REG to assist	ASP	End of July	Recommendations of salary structure and its implementation	

6	Steering committee to direct Finance Ministry to recommend policy changes concerning the replacement of VAT and unifying all different taxes into just one	Finance Ministry	AC to assist REG to assist	July	End of Aug	Recommendations	
7	Steering committee to launch a publicity campaign on war against corruption in petroleum sector	Finance Ministry	AC to assist REG to assist	ASP	For three months		To exhibit urgency and seriousness on the part of the government
Legal/Regulatory Steps							
8	Revise product quality law to implement the spirit of the law in a more flexible way	Standard Regulation Unit to convince Parliament	FM to monitor	ASP	End of June	Adoption by the Parliament	REG has taken some initiative in this process
9	Standard regulation unit to start dialogue with petroleum traders on revision and enforcement of product qualities to meet European standards	Standard Regulation Unit	AC to monitor	ASP	End of June	Optimum product standards	REG has taken some initiative in this process
10	SAROGR to enforce two reports developed by PAG	SAROGR	FM and AC	ASP	Continuous process	Refineries to operate as per rule of law	PAG/REG has taken some initiative in this process
11	SAROGR to continue to streamline the refining licensing procedures	SAROGR			Continuous process	Closing down of most refineries	FM has taken some steps
12	SAROGR to monitor crude oil production by oil companies by installing meters	SAROGR	Saknavtobi AC	ASP	End of June	More revenues to the state	Management changes at Saknavtobi should be a big help

13	SAROGR to improve its operation of monitoring crude oil price realization by oil companies	SAROGR	AC	ASP	End of June	More revenues to the state	PAG has taken some initiative in this process
14	To enter tamper proof metering at all service stations	ETI	Justice Department	ASP	End of August	A decree Better collection of VAT	Financial police needs to be trained to enforce this decree
15	ETI to develop and adopt implement a new reporting system to monitor product movement at service stations, terminals and by importers	ETI	Justice Department AC	ASP	End of June	Reporting format A new decree	REG has taken some steps in this process as well as ETI
16	ETI to get a decree/law adopted to enforce minimum requirements on petroleum importers	ETI	Justice Department	ASP	End of June	A decree	PAG has done a lot work in this area
17	ETI to adopt a decree to enforce the sale of petroleum products sold only through licensed outlets	ETI	Justice Department	ASP	End of June	A decree	
18	ETI to develop and adopt a new regulatory system to license terminals		Justice Department	ASP	End of June	A decree	
Technical							
19	Setting up a fully equipped petroleum testing lab either in the private sector or by the government to get more credible report	SC	SAROGR Standard Regulation Unit	ASP	End of August	Fully functioning lab	Donor agencies may help in setting up this lab

20	Customs to develop and implement a GPS system to monitor transit cargoes as well as petroleum trucks	Customs	Railways	ASP	End of August	GPS system installed	A paper outlining the system is developed at the request of REG
Auditing/monitoring/analytical							
21	Railways and customs to agree on uniform petroleum product codes	Railways Customs	AC	ASP	End of June	Agreed codes	REG has taken some initiative in this process
22	Railways and customs to complete the closing of transit for five months of 2004 based on the existing reporting system	Customs	AC/REG Railways	ASP	End of June	Calling for bank guarantees Improved revenues	REG has taken some initiative in this process
23	Tax department to conduct an audit on 25 top petroleum product importers to compare their product import vs sales vs taxes paid	Tax Department	AC/REG	ASP	End of June	Detecting of defaulters More revenues	REG has taken some initiative in this process
24	Standard Regulation Unit to conduct surprise and random testing of products at service stations, terminals and refineries	Standard Regulation Unit	SAROGR, AC Ministry of Finance	1 st, July	Continuous process	More revenues Improved product quality	
25	To conduct a scientific study of gasoline, diesel and LPG consumption using a market research company and a management school	Finance Ministry	REG to assist	June	July	Report giving estimates of consumption statistics	
26	To develop and implement a management information system to gather information on petroleum sector	Analytical Center	REG to assist	June	July	Various reports described in action plan Concept paper	

	Enforcement						
27	To close down those informal refineries which do not hold licenses by SAROGR and to monitor closely they are indeed not operating	SAROGR	Ministry of Finance Ministry of Justice General Prosecutor Ministry of security	ASP	Continuous process		Financial Police has taken some initiatives
28	To prosecute those licensed refineries which do not operate legally	SAROGR	Ministry of Finance General Prosecutor	ASP	Continuous process		
29	To prosecute those service stations which sell products not meeting quality requirement	Standard Regulation Unit	Ministry of Finance General Prosecutor	ASP	Continuous process		
30	To make random inspection at guarded and unguarded borders to look for contraband petroleum products	Financial Police Border guards	General Prosecutor	ASP	Continuous process		Financial Police has taken some initiatives
31	To inspect railways tank cars on a random basis to find out if they do indeed have proper certificates	Financial Police	General Prosecutor	ASP	Continuous process		
32	To close down all those testing labs which do not meet minimum requirements	Standard Regulation Unit	General Prosecutor	ASP	Continuous process		
33	Standard Regulation Unit along with Financial Police should take random samples of imported products at customs to detect fraudulent declaration of products	Standard Regulation Unit	Ministry of Finance General Prosecutor	ASP	Continuous process		Total surprise and randomness is important

34	Standard Regulation Unit along with Financial Police should take random samples of diesel from Mashutkas to detect illegal use of diesel	Standard Regulation Unit	Ministry of Finance General Prosecutor	ASP	Continuous process		
35	Financial Police to take action against those illegal traders of petroleum products who sell without licenses on the roadside and from backyards	Financial Police	ETI General Prosecutor	ASP	Continuous process		

3. TOBACCO PRODUCTS

The REG stakeholders working on improved excise tax collection in tobacco products were assisted by industry experts provided by the Tobacco Merchants Association (TMA). TMA's analysis and summary stakeholder recommendations are presented below.

1. Objective

1.1 Main Objective

The Tobacco Merchants Association has been tasked with understanding and evaluating the key impediments existing in the Georgian cigarette market in an effort to increase excise tax revenues for the Georgian government without negatively affecting the competitive forces within the tobacco industry sector. This objective requires the recommendation of specific short, medium and longer term actions that the Minister of Finance should exercise to accomplish this goal, all backed by solid quantitative and qualitative data drawn from comparable situations in other parts of the world.

1.1.1 Who is TMA?

The Tobacco Merchants Association was founded in 1915 to manage information of vital interest to the worldwide tobacco industry. TMA's membership includes virtually all companies in the following sectors: cigarette, cigar, pipe and chewing tobacco, snuff, and leaf tobacco, as well as industry suppliers, securities analysts, advertising agencies, management consultants, distributors, wholesalers, retailers, importers and exporters, and others who value rapid delivery of critical information. Today, the TMA continues to function as a trade association and remains dedicated to supplying factual information to a variety of companies, associations, and other organizations, whose livelihoods depend upon timely, comprehensive and accurate data about the global tobacco business.

TMA's databank is drawn from over 10,000 domestic and international sources and is constantly updated through a collection of computerized databases, which yield daily, weekly, biweekly, monthly, quarterly, semi-annual, and annual reports. This monitoring and reporting system allows TMA to provide its supporters with a single, consistent source for economic, legislative, regulatory, trademark, brand, and statistical data: market by market, and company by company. TMA is the foremost source for current, objective information on the worldwide tobacco industry and provides easy access to this information through its publications and programs.

1.2 Key Participants

Several key participants contributed vital information and expertise to TMA that led to the formation of this report. Without their input, this report would not be possible. These key participants include:

- Georgia Enterprise Growth Initiative (GEGI)/BearingPoint
- Georgia Ministry of Finance
- Georgia Excise Tax Inspectorate
- Foreign and local cigarette manufacturers in the Georgian market

- Georgia Business Confederation.

2. The Georgian Cigarette Market

2.1 Market Demographics

This section presents cigarette market demographics for Georgia that were culled from a variety of source information which is cited at the end of this section. Appendix B collects this information in total.

- About 30% of the adult Georgian population smokes, roughly one million people.
- About 26% of all smokers smoke less than 11 cigarettes per day.
- About 43% of all smokers smoke between 11 and 20 cigarettes per day.
- About 31% of all smokers smoke more than 20 cigarettes per day.
- Roughly 35% of all domestically-produced cigarettes are filtered.
- Roughly 90% of all imported cigarettes are filtered.
- Over 99% of all cigarettes consumed in Georgia are American-blend, which consists of flue-cured, burley and oriental tobacco leaf.
- Imported cigarettes account for about 60% of the market.

Sources: TACIS Research (1999), World Health Fund, PNL

2.2 Industry Participants

The following list displays those companies that sell cigarettes in Georgia:

Domestic Manufacturers (6)

Georgian Tobacco Manufacture (GTM)

Kazbegi

Kolkheti 2002

Omega (OGT) - Facility has been sealed off by government since 2/19/2004

Poseidon

Tbilisi 2002

Multinational Companies With Import Sales Offices (5)

Altadis

British American Tobacco (BAT)

Japan Tobacco International (JTI)

Philip Morris International (PM)

Production & Network Ltd. [PNL] (Imperial Tobacco - UK)

2.3 Cigarette Brands and Their Prices

The following list displays those cigarette brands (and their prices in Lari/US\$ per pack of 20) that were found to be sold in Tbilisi, Georgia during April 2004:

Domestically-Produced Brands

	<u>Lari</u>	<u>US\$</u>
Star (GTM)	0.7	0.35
Pirveli	0.9	0.45
Viceroy [Licensed] (GTM, BAT)	1.0	0.50

International Brands

	<u>Lari</u>	<u>US\$</u>
Camel (JTI)	1.7	0.85
Davidoff (PNL)	3.0	1.50
Fusion (PNL)	2.0	1.00
Gauloises (Altadis)	1.7	0.85
Kent (BAT)	2.5	1.25
L & M (PM)	1.5	0.75
Lucky Strike (BAT)	1.5	0.75
Magna (JTI)	1.2	0.60
Marlboro (PM)	2.5	1.25
MM (PNL)	1.2	0.60
More (JTI)	0.9	0.45
Winston (JTI)	1.5	0.75

2.4 Determining The Size and Scope of the Georgian Cigarette Market

Before any analysis or recommendations can be made, we must first determine what is the actual size of the Georgian cigarette market. Currently, the Georgian central government has no viable data analytical capability within its Excise Tax Inspectorate, making it highly improbable that it knows the actual size of the market. The government's excise tax stamp sales should give a clear indication as to the size of the legal market, but even this accounting process was not available.

During its trip, TMA procured market size data estimates from numerous sources and forged a "reasonable" market size figure that integrates many of these estimates.

2.4.1 Cigarette Market Size/Scope Estimates from News Sources

Below are several sourced reports that help identify the market. Using these reports, we have derived a market for which we can base our calculations.

(1) Source: Sarke News Agency – September 29, 2003

According to Japan Tobacco International, there are 6.5 billion cigarettes consumed in Georgia each year. Of that total, 2.5 billion pieces are legally imported, while domestic manufacturers account for another 300 million pieces.

(2) Source: Svobodnaya Gruzia – February 17, 2003

According to market observers, about 7.3 billion cigarettes are sold in Georgia per year.

- (3) Source: TACIS research 1999; World Health Fund

The Georgian cigarette market is roughly 8.64 billion pieces each year, of which 60% are imports.

- (4) Source: US Department of Agriculture - Foreign Agricultural Service

The Georgian cigarette market is 8.9 billion pieces each year, with 1.5 billion pieces consisting of imports.

2.4.2 TMA's Assumptions Concerning the Size and Scope of the Georgian Cigarette Market

TMA makes the following assumptions for the Georgian cigarette market for 2003:

- 7.3 billion pieces in total
- 50% imports, 50% domestically-produced
- 90% of all imported cigarettes are filtered
- 50% of all domestically-produced cigarettes are filtered
- 40% of all imported cigarettes are tax-paid (legal)
- Two-thirds (66.7%) of domestically-produced cigarettes are tax-paid (legal).

The explanations for each of these assumptions are as follows:

(1) *The estimated size of the Georgian cigarette market*

Due to the large amount of illegal activity of the Georgian cigarette market, determining the “actual” size of the market will require some assumptions and some calculations. Our first assumption is that the habits of smokers in Georgia approximate those in Armenia, so that there are about one million smokers in Georgia (which represents about 30 percent of all adults in the country, or 3.33 million people over 18).

By multiplying the estimated smokers' population in Georgia (1 million) by the estimated adult per capita consumption rate ($20 * 365 = 7,300$ cigarettes per year), we get a 7.3 billion piece market.

Since there is no centralized data reconciliatory center to confirm any estimate of the Georgia cigarette market's size, this measure seems right as it stands about midway between the high-end estimates of about 8.6 billion pieces and the low-end estimates of 6.5 billion pieces from our source material.

(2) *The percentage of imports of the Georgian cigarette market*

Many of the same sources for which we found market size estimates also gave percentages as to the size of imports to the total market. This figure includes legal imports for which import cigarette excise tax stamps were properly affixed plus the illegal imports that consisted of unstamped cigarettes, illegally-stamped cigarettes and counterfeit cigarettes (with both legitimate stamps and illegitimate stamps). Imports have been seen to account for more than half of the total market by many sources, but 50% was chosen based on the survey results and the anecdotal knowledge of industry stakeholders who filled out questionnaires about the Georgia cigarette market.

(3) *The percentage of filtered cigarettes in the Georgian cigarette market*

These filter percentages, 90% of all imported cigarettes and 50% of all domestically-produced cigarettes, were based on the survey results and the anecdotal knowledge of industry stakeholders who filled out questionnaires about the Georgia cigarette market.

(4) *The percentage of legal (tax-paid) cigarettes in the Georgian cigarette market*

These percentages, 40% of all imported cigarettes and 67% of all domestically-produced cigarettes, were based on the survey results and the anecdotal knowledge of industry stakeholders who filled out questionnaires about the Georgia cigarette market.

ESTIMATED CIGARETTE SALES - 2003 (BY SEGMENT)

Legal domestically-produced cigarettes – Filtered	1,216.67 mn pieces
Legal domestically-produced cigarettes – Non-Filtered	1,216.67 mn pieces
Illegal domestically-produced cigarettes – Filtered	608.33 mn pieces
Illegal domestically-produced cigarettes – Non-Filtered	608.33 mn pieces
Legal imported cigarettes – Filtered	1,314.00 mn pieces
Legal imported cigarettes – Non-Filtered	146.00 mn pieces
Illegal imported cigarettes – Filtered	1,971.00 mn pieces
Illegal imported cigarettes – Non-Filtered	219.00 mn pieces
TOTAL	7,300.00 mn pieces

3. The Estimated Tax Revenue and Leakage from the Georgian Cigarette Market

3.1 Types of Cigarette Excise Tax Leakage in Georgia

Excise tax leakage is defined as the excise tax revenue lost by the central government from illegal activity conducted by those who produce, transport, distribute or sell cigarettes in the Georgia market. In total, TMA has cited six distinct types of cigarette excise tax leakage have been detected in the Georgian cigarette market. All of these types are in violation of current Georgian law and are as follows:

(1) *The illegal use of counterfeit excise tax stamps on cigarettes manufactured domestically.*
(40% of all cigarette excise tax leakage for the domestic cigarette market)

The duplication of cigarette excise tax stamps designated for domestically-produced cigarettes is one of the main illegal activities involving domestic cigarette companies. A cigarette excise tax stamp, which is first purchased through the correct legal channel in coordination with the Excise Tax Inspectorate, is then reproduced using advanced printing technology that can easily be obtained. Since the stamp's serial numbers are not yet being reconciled by the Excise Tax Inspectorate's Enforcement Group, the same copied serial numbers can reappear on multiple cigarette packages. Generally, these counterfeit stamps do not have the covert portions reproduced which make them easy to identify if the proper detection equipment is used correctly. Currently, local cigarette makers are

visited once a year by excise tax audits, more if there is any cause of suspicion. Therefore, identifying violators is extremely difficult.

- (2) ***The illegal use of re-used excise tax stamps on cigarettes manufactured domestically.***
(40% of all cigarette excise tax leakage for the domestic cigarette market)

Similarly, the re-use of cigarette excise tax stamps on domestically-produced cigarettes is also a common occurrence in the market. At some point, whether at the distributor level, the retail level or even at the post-purchase level, the cigarette excise tax stamp is carefully removed from the package to be re-used in the production process. With stamps placed inside the packaging, they are generally removed as the consumer has purchased and possibly dispensed of the used, empty package. As with the case of counterfeit excise tax stamps, the re-used stamp's serial numbers were not originally reconciled and therefore cannot be traced if the re-used stamp is attached to a package made by the manufacturer who originally purchased the stamp.

- (3) ***The existence of a barter system whereby cigarettes are manufactured just inside the Russian border, yet are considered domestically-produced.***
(20% of all cigarette excise tax leakage for the domestic cigarette market)

There reportedly is a situation where Russian cigarette makers produce their products right across the border using raw materials that were obtained in Georgia. The accounting is seen as a barter and therefore the cigarettes are not considered imports, but as if there are domestically-produced.

Please note that this information was provided in an anecdotal nature and could not be confirmed. Also, if the cigarette packs yield legitimate excise tax stamps for domestically-produced cigarettes, then some tax revenue exists and the leakage is from the difference between the cost of the import and domestic cigarette tax stamps.

- (4) ***The illegal import of cigarettes that were not manufactured in Georgia (border smuggling).***
(25% of all cigarette excise tax leakage involving cigarette imports)

Due to Georgia's unstable borders at the Ergneti, Abkhazia and Zugdidi regions, cigarettes are able to enter Georgia without the approval of the central government. These illegal cigarettes are classified at the traditional view of smuggling. Until political stability is reached for these regions, this type of border smuggling will continue.

- (5) ***The illegal import of counterfeit cigarettes bearing counterfeit cigarette excise tax stamps into Georgia.***
(35% of all cigarette excise tax leakage involving cigarette imports)

Well-known international cigarette brands such as *Marlboro*, *Camel* and *Winston* are always vulnerable to producers who abuse intellectual property rights. By producing counterfeit versions of these well-known brands, consumers are tricked into purchasing inferior products. Forging cigarette excise stamps along with the fraudulent packaging is done with high levels of printing technology which is cheap in today's age. Georgia's customs border officials must be properly trained as well as be properly motivated to observe the nation's laws. Until they, along with the Excise Tax Inspectorate's Enforcement Group, get the proper training and equipment to detect illegal cigarette packs, this type of illegal activity will continue.

- (6) ***The illegal import of cigarettes bearing counterfeit cigarette excise tax stamps into Georgia.***
(40% of all cigarette excise tax leakage involving cigarette imports)

As mentioned in (1), the duplication of cigarette excise tax stamps designated for imported cigarettes is also one of the main illegal activities in the tobacco industry. A cigarette excise tax stamp, which is first purchased through the correct legal channel in coordination with the Excise Tax Inspectorate, is then reproduced using advanced printing technology that can easily be obtained. Until the Excise Tax Inspectorate's Enforcement Group gets the proper training and equipment to detect illegal cigarette packs, this type of illegal activity will continue.

3.2 Calculating the Leakage Segments of the Georgia Cigarette Market for 2003

By applying the total illegal domestically-produced and imported cigarette figures presented in Section 2.4.2 to the percentages of each segment of tax leakage in Georgia presented in Section 3.1, the following cigarette sales figures are estimated for Georgia in 2003 by each leakage segment:

Illegal domestically-produced cigarettes (1,216.67 million pieces):

Counterfeit - Filtered	243.33 mn pieces
Counterfeit - Non-Filtered	243.33 mn pieces
Re-used Stamps - Filtered	243.33 mn pieces
Re-used Stamps - Non-Filtered	243.33 mn pieces
Barter Method - Filtered	121.67 mn pieces
Barter Method - Non-Filtered	121.67 mn pieces

Illegal imported cigarettes (2,190.00 million pieces):

Border Smuggling - Filtered	492.75 mn pieces
Border Smuggling - Non-Filtered	54.75 mn pieces
Counterfeit Cigarettes & Stamps - Filtered	689.85 mn pieces
Counterfeit Cigarettes & Stamps - Non-Filtered	76.65 mn pieces
Counterfeit Stamps only - Filtered	788.40 mn pieces
Counterfeit Stamps only - Non-Filtered	87.60 mn pieces

3.3 Estimating Tax Revenue and Leakage for Georgia

After calculating for the different cigarette segments of the market, we can now multiply each segment by its appropriate excise tax rate which are given below.

CURRENT CIGARETTE EXCISE TAX RATES:

Domestically-produced filtered cigarettes	-	10 lari/1,000 pieces
Domestically-produced non-filtered cigarettes	-	3.5 lari/1,000 pieces
Imported filtered cigarettes	-	20 lari/1,000 pieces
Imported non-filtered cigarettes	-	10 lari/1,000 pieces

NOTE: The cigarette excise tax rate for imported cigarettes also takes into account the import duty and VAT. The cigarette excise tax rate for domestically-produced cigarettes also takes into account the VAT.

ESTIMATED CIGARETTE EXCISE TAX REVENUE - 2003 (IN MILLIONS OF LARIS AND MILLIONS OF US\$)

	Lari	US\$
Legal domestically-produced filtered cigarettes	12.167	6.083

Legal domestically-produced non-filtered cigarettes	4.258	2.129
Legal imported filtered cigarettes	26.280	13.140
Legal imported non-filtered cigarettes	1.460	0.730
TOTAL	44.165	22.083

ESTIMATED CIGARETTE EXCISE TAX REVENUE LEAKAGE - 2003
(IN MILLIONS OF LARI AND MILLIONS OF US\$)

	Lari	US\$
Illegal domestically-produced cigarettes:		
Counterfeit – Filtered	2.433	1.217
Counterfeit - Non-Filtered	0.852	0.426
Re-used Stamps – Filtered	2.433	1.217
Re-used Stamps -Non-Filtered	0.852	0.426
Barter Method – Filtered	1.217	0.608
Barter Method - Non-Filtered	0.426	0.213
Illegal imported filtered cigarettes:		
Border Smuggling – Filtered	9.855	4.928
Border Smuggling - Non-Filtered	0.548	0.274
Counterfeit Cigarettes & Stamps – Filtered	13.797	6.899
Counterfeit Cigarettes & Stamps - Non-Filtered	0.767	0.383
Counterfeit Stamps only – Filtered	15.768	7.884
Counterfeit Stamps only - Non-Filtered	0.876	0.438
TOTAL	49.823	24.911

In essence, while the Georgian government in 2003 collected 44.17 million lari in cigarette excise tax, over 49.82 million lari went uncollected in the form of excise tax leakage due to the different types of illegal activity in Georgia.

4. The Current Level of Public Policy for the Georgian Cigarette Market

4.1 The Current Cigarette Excise Tax Structure for Georgia

The cigarette excise tax in Georgia is specific, meaning that it is based on a quantitative or volume measure. Excise taxes can also be *ad valorem*, meaning that they are based on a percentage of the value of the product in question. Specific taxes can be argued to be less discriminatory as they take no regard as to product quality or price.

In the case of Georgia, the import duty payment and the VAT payment are incorporated into the excise tax stamp payment for imported cigarettes. Paying for all three charges simultaneously makes sales and paperwork simpler. For domestically-produced cigarettes, the VAT payment is incorporated into the excise tax stamp payment.

The current cigarette excise tax structure, which is scheduled to change on July 1, 2004, is shown as:

Imported filtered cigarettes	-	0.40 lari/pack of 20
Imported non-filtered cigarettes	-	0.20 lari/pack of 20
Domestically-produced filtered cigarettes	-	0.20 lari/pack of 20
Domestically-produced non-filtered cigarettes	-	0.07 lari/pack of 20

4.2 The New Cigarette Excise Tax Structure for Georgia

Earlier this year, the government announced changes to the cigarette excise tax structure that they believe will increase tax revenues. The gist of the changes includes a tax increase for domestically-produced cigarettes and the separation of the VAT payment from the excise tax payment.

The new cigarette excise tax structure, which is scheduled goes into effect on July 1, 2004, is shown as:

Imported filtered cigarettes	-	0.40 lari/pack of 20
Imported non-filtered cigarettes	-	0.20 lari/pack of 20
Domestically-produced filtered cigarettes	-	0.25 lari/pack of 20
Domestically-produced non-filtered cigarettes	-	0.10 lari/pack of 20

The VAT separation is relevant as it will immediately increase prices by 20%, the amount of the VAT. For example, a pack of domestically-produced cigarettes that retails at 1 lari per pack will now be priced at 1.2 lari/pack, while a pack of import cigarettes that retails at 1.5 lari per pack will now be priced at 1.8 lari/pack.

4.3 The Tariff Schedule for Cigarette Imports to Georgia

According to World Tariff, a group that collects and disseminates (for profit) import tariff schedules for countries around the world, the import duty for manufactured tobacco product, which includes cigarettes, cigars, smoking tobacco, smokeless tobacco, "homogenized"/"reconstituted" tobacco and tobacco extracts and essences that are used in tobacco processing, is 30 percent of the customs value of the imported good.

Tobacco products imports from CIS nations may be eligible for preferential treatment. There is also a Customs Handling Fee of 0.15% of the duty-paid value and a Customs Inspection Fee of 0.01 lari per kilogram.

Since Georgia's excise tax stamp for imported cigarettes incorporates the import duty payment component, the 30 percent tariff is not directly applied to the cigarettes. However, the small incidental fees (Customs Handling and Customs Inspections) are paid at the point of importation.

4.4 A Comparison of Tariff, Excise Tax and VAT Rates between Georgia and Neighboring Countries

The following table lists Georgia's cigarette tariff, excise tax and VAT rates in relation to neighboring countries:

Country	Tariff Rate	Excise Tax Rate	VAT (%)
Armenia	None	US\$ 11/1000p	20.0%
Azerbaijan	US\$ 0.50/1000p	9,000 marat/1000p	18.0%
Byelarus	30%	1.8 euros/1000p	20.0%
Estonia	None	24% + 210 kroon/1000p	18.0%
Georgia	30%	10 lari/1000p	20.0%
Kazakhstan	5% CIF	180 tenge/1000p	16.0%
Kyrgyzstan	10%	70 soms/1000p	20.0%
Latvia	10%	6.1% + 6.3 lats/1000p	18.0%
Lithuania	30%	15% + 47.5 litas/1000p	18.0%
Moldova	3 euros/1000p	US\$ 3.5/1000p	20.0%
Russia	30% CIF	5% + 60 rubles/1000p	18.0%
Tajikistan	US\$ 3/1000p	US\$ 0.50/1000p	20.0%
Turkmenistan	150% (US\$ 1/pack)	30%	20.0%
Ukraine	3 euros/1000p	14 hryvnia/1000p	20.0%
Uzbekistan	30% CIF	38% (hard); 45% (soft)	20.0%
Turkey	57.6% CIF	55.3% + 2,500,000 TL/1000p	18.0%
Pakistan	25% CIF	63%	15.0%
Iran	4% CIF	5%	NA

Georgia's rates in comparison to other countries:

Country	Tariff Rate	Excise Tax Rate (US\$/1000p)	VAT
Armenia	NA	US\$ 11.00 (Lower by US\$ 6.00)	Same
Azerbaijan	NA	US\$ 1.82 (Higher by US\$ 3.18)	Higher by 2%
Russia	Same	US\$ 2.10 (Higher by US\$ 2.90)	Higher by 2%
Turkey	Lower	US\$ 14.40 (Lower by US\$ 9.10)	Higher by 2%
Ukraine	NA	US\$ 2.63 (Higher by US\$ 2.37)	Same

Most notably, Russia's cigarette tariff and tax rates are lower than Georgia's, the main reason that most of the cigarettes that are smuggled into Georgia originate from Russia.

4.5 Cigarette Prices in Neighboring Countries to Georgia

One important reason Georgia is faced with cigarette smuggling and counterfeit stamps is the relatively high cigarette prices in Georgia compared to prices in neighboring countries. The table below illustrates cigarette prices around the region.

Brand	Country	US\$
Camel (JTI)	Georgia	0.85
Kent (BAT)	Georgia	1.25
Lucky Strike (BAT)	Georgia	0.75
Marlboro (PM)	Georgia	1.25
Viceroy (BAT/GTM)	Georgia	0.50
Winston (JTI)	Georgia	0.75
Marlboro (PM)	Armenia	1.00
Kent (BAT)	Azerbaijan	1.00
Lucky Strike (BAT)	Azerbaijan	0.75
Marlboro (PM)	Azerbaijan	1.00
Viceroy (BAT)	Azerbaijan	0.50
Camel (JTI)	Russia	0.60
Kent (BAT)	Russia	0.77
Lucky Strike (BAT)	Russia	0.70
Marlboro (PM)	Russia	0.66
Winston (JTI)	Russia	0.43
Camel (JTI)	Ukraine	0.60
Kent (BAT)	Ukraine	0.80
Lucky Strike (BAT)	Ukraine	0.65
Marlboro (PM)	Ukraine	0.69
Winston (JTI)	Ukraine	0.50

It is no wonder that almost of all of the contraband market is composed of cigarettes that were produced in Russia or the Ukraine as the cigarette prices in these markets are much cheaper than the prices in Georgia.

4.6 The Flow of Cigarette Excise Tax Stamps in Georgia

(1) *The stamp for domestically produced cigarettes.*

Domestic cigarette makers file an application form to purchase cigarette stamps from the Excise Tax Inspectorate (Ministry of Finance). There are no laws that restrict who can purchase cigarette excise tax stamps. The stamp purchaser places its money for the stamps with the Bank of Georgia or some other government-recognized financial institution. The stamp purchaser physically picks up the stamps at the Excise Tax Inspectorate offices to ensure their delivery to the cigarette production facilities.

When the domestic cigarette maker files a second application to purchase more stamps, the applicant must list its remaining stamp balance for accounting purposes.

(2) *The stamp for imported cigarettes.*

Foreign cigarette manufacturers file an application form from the Excise Tax Inspectorate (Ministry of Finance) to purchase cigarette excise tax stamps for their products to enter Georgia. The Georgian

government has no restrictions in terms of who can purchase stamps. The stamp purchaser must place its money for the stamps with the Bank of Georgia or some other government-recognized institution.

NOTE: The excise tax stamp for imported cigarettes differs in color and shape from the excise tax stamp for domestically produced cigarettes. The excise tax stamp for imported cigarettes is yellow, while the excise tax stamp for domestically produced cigarettes is blue.

Georgia's cigarette excise tax stamps have a recorded series of serial numbers among other measures, both overt and covert. The stamps are then directly mailed to the foreign cigarette manufacturer. However, there have been reported instances where the stamps are not completely delivered to the foreign manufacturer. These diverted stamps are sometimes used by the interceptor or forged by the interceptor, depending on the level of their illegal activity.

Upon receipt of the stamps, the foreign cigarette manufacturer applies them to the inside of its cigarette packs and ships its product to Georgia. The stamps are designed to be applied directly to the cigarette pack, to be covered by a polypropylene layer. These cigarettes are also to display the correct health warning messages and size as mandated by the Georgian government.

When the foreign manufacturer's shipment arrives at Georgia's customs offices, the Georgia-based importer (company representative) is notified. This importer is to then report to the Excise Tax Inspectorate's office to receive a "transit card" showing the quantity delivered, the total excise tax payment made and the tax stamp serial numbers used. The importer brings this card to the customs office. The customs office is to document its work, making sure that the card is legitimate and inspects up to two percent (2%) of the imported shipment. The customs office is to be equipped with special detection devices that were provided by the stamp maker to certify their authentication.

If the sample shipment fails, it is not clear what is the customs office next official step as the law is unclear whether the shipment is to be seized or the importer is to be arrested. There has never been a case where a sample shipment failed.

(3) *The wholesale trade sector.*

The Ministry of Finance has recently commissioned a group of tax investigators called the Financial Police whose task it is to ensure the legal compliancy of excise taxes for tobacco products, alcoholic beverages and petroleum products. These investigators will be equipped with the same special detection devices provided by the stamp manufacturer that the customs officers will be using at Georgia's points of entry.

The Financial Police will be charged with ensuring that all licensed cigarette wholesalers (who are also called distributors, subjobbers, or middlemen) are transporting or handling cigarettes that are legitimately stamped cigarettes, whether domestically produced or imported.

Current law states that if a cigarette manufacturer or wholesaler is found with more than 10 unstamped or falsely-stamped cigarette packs (200 cigarettes), then the packs are confiscated and the facility or warehouse is given a complete inspection. A criminal lawsuit can also be filed against the manufacturer or wholesaler.

(4) *The retail trade sector.*

Cigarette retailers in Tbilisi are primarily women street vendors who are supplied from the trunks of cars. Based on our observations, having the Financial Police inspect retail cigarette dealers on the

legitimacy of their tax-stamped wares would probably not be efficient, nor prudent. The situation must be controlled at the higher wholesale level.

4.7 The De La Rue Cigarette Excise Tax Stamp

In March 2004, the tender commission of the Georgian Finance Ministry named UK-based De La Rue International to print and supply excise tax stamps for the Georgian cigarette, beer and alcoholic beverage markets. The Finance Ministry said it based its decision on criteria including cost, quality parameters and the protection regime offered by the bidders.

On April 2, 2004, the official agreement between the Georgian Finance Ministry and De La Rue was entered whereby De La Rue would supply 200 million cigarette excise tax stamps for imported cigarettes. The agreement cites that the excise tax stamps shall contain several layers and sides of overt and covert seals concerning the stamp's print, holograms and type of paper.

Beginning January 1, 2004, stamp buyers were required to pay for the cost of the stamps a banderole tax of 0.015 lari/pack (0.75 lari/1,000 pieces).

De La Rue International (London Stock Exchange: DLAR) is the world's largest commercial security printer and papermaker, involved in the production of over 150 national currencies and a wide range of security documents such as travelers checks, vouchers and excise tax stamps. De La Rue is also pioneering new technologies including tailored solutions to protect the world's brands through to government identity solutions in secure passports, identity cards and driver's licenses.

NOTE: TMA was unable to examine the contract between the Georgia government and De La Rue.

5. TMA's Analysis of Public Policy for the Georgian Cigarette Market

5.1 Data Gathering

TMA utilized many different ways of acquiring the data it needed to create this report. Some of the ways were very traditional (news, internal reference sources, law collection, questionnaires, interviews) while others were less conventional (test sampling and direct observation).

All of the data collected for this report are described in this section appears in Appendix B.

5.1.1 News Collection

TMA's systems contain a 20-year collection of international news stories dealing solely with the worldwide tobacco industry. Summoning those articles relating to the Republic of Georgia revealed information concerning the nation's market size and conditions and well as information involving the government's agreement with De La Rue.

5.1.2 Reference Data/Law Collection

TMA's systems also contain the International Tobacco Guide (ITG) and the International Public Policy Guide (IPPG).

The ITG, a 2,000-page reference source that describes the local tobacco industry for 153 countries including Georgia, was used to collect macroeconomic data, tobacco product market data, and tariff and tax rates. The IPPG, a 500-page reference source that describes the current public policy (law) situation for 111 countries including Georgia, gave a list of the relevant Georgian laws dealing with taxation, promotion and advertising, packaging and labeling, and sales distribution. This section was incomplete as many of Georgia's laws concerning the tobacco industry were unavailable.

GEGI was also vital in helping TMA acquire several cigarette tax laws.

5.1.3 Questionnaires

At the April 20th tobacco stakeholders meeting, TMA and GEGI presented all of the meeting's participants with a five-page questionnaire that asked about their insight into the Georgian cigarette market. Only two questionnaires were received by TMA. These two companies will remain anonymous in this report. The data collected resulting from the two questionnaires has been incorporated into this report.

5.1.4 Interviews

TMA conducted or participated in a number of interviews during its stay in Tbilisi. The results from these interviews were placed in the trip reports, with the data collected having been incorporated into this report.

5.1.5 Test Sampling

A random sampling of discarded cigarette packs found in the vicinity of downtown Tbilisi was conducted. Although no data resulting from the sampling was used for this report, the sampling was used in interviews for other issues such as stamping.

Sampling was also conducted to collect cigarette brand prices in the vicinity of downtown Tbilisi.

5.1.6 Direct Observation

Although there was no time to meet with or observe customs officials or the Excise Tax Inspectorate's Enforcement Group, activity of the retail sector was observed. Those observations are included in this report. No cigarette manufacturing facilities were visited in Georgia.

5.2 Forecasting The Georgia Cigarette Market: If The Current Government Cigarette Excise Tax Policy is Implemented

Using the TMA-derived 2003 figures in Section 3.3 as a base, we will forecast and compare cigarette excise tax revenue and leakage for the Georgia cigarette market if the Georgian government implements its currently scheduled cigarette excise tax policy.

(a) *The breakdown of the Georgian cigarette excise tax structure*

With the Georgian government planning to separate the VAT from the cigarette excise tax on July 1, 2004, a breakdown of the cigarette excise tax revenue in terms of import duty, excise tax and VAT for 2003 must be created for comparative reasons.

CURRENT CIGARETTE EXCISE TAX RATES:

Domestically-produced filtered cigarettes	-	10 lari/1,000 pieces
Domestically-produced non-filtered cigarettes	-	3.5 lari/1,000 pieces
Imported filtered cigarettes	-	20 lari/1,000 pieces
Imported non-filtered cigarettes	-	10 lari/1,000 pieces

The breakdown is quite simple. The excise tax for imported cigarettes contains the import duty payment, the excise tax and the VAT, while the excise tax of domestically-produced cigarettes contains just the excise tax and the VAT. Therefore, the import duty payment can be separated out as the difference between the two tax rates. For filtered cigarettes, the imported duty payment would be 10 lari/1,000 pieces, while for non-filtered cigarettes, the imported duty payment would be 6.5 lari/1,000 pieces.

Deciphering the VAT is a bit more tricky. Since the VAT rate is 20% of the value, that means it is 16.67% of the retail price. This, however, would not make sense as the VAT would account for 83.33% of the value of the excise tax stamp. Since the revenue is counted towards excise tax collection and not VAT tax collection, a different assumption needs to be made. We shall assume then that the VAT is one-sixth of the excise tax stamp amount or 1.667 lari/1,000 pieces for filtered cigarettes and 0.583 lari/1,000 pieces for non-filtered cigarettes. Thus, the breakdown for the 2003 tax structure is:

1.Import Duty - Filtered cigarettes	-	10.000 lari/1,000 pieces
2.Import Duty - Non-Filtered cigarettes	-	6.500 lari/1,000 pieces
3.Excise Tax - Filtered cigarettes (both imp. & dom.)	-	8.333 lari/1,000 pieces
4.Excise Tax - Non-filtered cigarettes (both imp. & dom.)	-	2.917 lari/1,000 pieces
5.VAT - Filtered cigarettes (both imp. & dom.)	-	1.667 lari/1,000 pieces
6.VAT - Non-filtered cigarettes (both imp. & dom.)	-	0.583 lari/1,000 pieces

If we sum up items (1), (3), and (5), we get 20 lari/1,000 pieces, the value of the excise tax for imported cigarettes that are filtered. All of the other combinations would work in a similar fashion.

(b) *Incorporating the stamp (banderole) tax payment*

Beginning January 1, 2004, cigarette excise tax buyers were charged an additional fee to cover the cost of the stamps. This fee of 0.75 lari/1,000 pieces has been incorporated into the model.

(c) *Incorporating the Georgian government's proposed changes into the current cigarette excise tax structure*

On July 1, 2004, the Georgian government plans to incorporate its changes to the current cigarette excise tax structure. Those changes are:

1. Increasing the excise tax for domestically-produced filtered cigarettes from 10.00 lari/1,000 pieces to 12.50 lari/1,000 pieces.
2. Increasing the excise tax for domestically-produced non-filtered cigarettes from 3.50 lari/1,000 pieces to 5.00 lari/1,000 pieces.
3. Introducing a separate VAT of 20% to all cigarette sales.

To quantify the VAT, we will take the average retail price of a domestic brand of filtered cigarettes (which includes the new cigarette tax increase of 2.5 lari per 1,000 pieces) of 1.05 lari/pack of 20 to get 0.21 lari/pack of 20 or 10.5 lari/1,000 pieces. For non-filtered cigarettes, we will take the average price (which includes the new cigarette tax increase of 1.5 lari per 1,000 pieces) of 0.7 lari/pack of 20 to get the VAT payment of 0.14 lari/pack of 20 or 7 lari/1,000 pieces.

To quantify the VAT for imports, we will take the average retail price of a domestic brand of filtered cigarettes of 1.6 lari/pack of 20 to get 0.32 lari/pack of 20 or 16 lari/1,000 pieces. For non-filtered cigarettes, we will take the average price of 1.2 lari/pack of 20 to get the VAT payment of 0.24 lari/pack of 20 or 12 lari/1,000 pieces.

Therefore, the new tax structure on July 1, 2004 would look like this:

1.Import Duty - Filtered cigarettes	-	10.000 lari/1,000pieces
2.Import Duty - Non-Filtered cigarettes	-	6.500 lari/1,000pieces
3.Excise Tax - Filtered cigarettes - Imported	-	10.000 lari/1,000pieces
4.Excise Tax - Non-filtered cigarettes –Imported	-	3.500 lari/1,000pieces
5.Excise Tax - Filtered cigarettes - Domestic	-	12.500 lari/1,000pieces
6.Excise Tax - Non-filtered cigarettes – Domestic	-	5.000 lari/1,000pieces
7.VAT - Filtered cigarettes - Imported	-	16.000 lari/1,000pieces
8.VAT - Non-filtered cigarettes - Imported	-	12.000 lari/1,000pieces
9.VAT - Filtered cigarettes - Domestic	-	10.500 lari/1,000pieces
10.VAT - Non-filtered cigarettes - Domestic	-	7.000 lari/1,000pieces

Because the new tax structure is being implemented on July 1st, only half of the year's cigarette sales will be affected by the changes. The above rates would be effective for 2005-07 in terms of our calculations. The average tax structure for 2004 would be:

1.Import Duty - Filtered cigarettes	-	10.000 lari/1,000 pieces
2.Import Duty - Non-Filtered cigarettes	-	6.500 lari/1,000 pieces
3.Excise Tax - Filtered cigarettes - Imported	-	10.000 lari/1,000 pieces
4.Excise Tax - Non-filtered cigarettes - Imported	-	3.500 lari/1,000 pieces
5.Excise Tax - Filtered cigarettes - Domestic	-	11.250 lari/1,000 pieces
6.Excise Tax - Non-filtered cigarettes - Domestic	-	4.250 lari/1,000 pieces
7.VAT - Filtered cigarettes - Imported	-	8.834 lari/1,000 pieces
8.VAT - Non-filtered cigarettes - Imported	-	6.292 lari/1,000 pieces
9.VAT - Filtered cigarettes - Domestic	-	6.084 lari/1,000 pieces
10.VAT - Non-filtered cigarettes - Domestic	-	3.792 lari/1,000 pieces

(d) *Other Assumptions*

The following assumptions regarding the Georgian cigarette market were also made.

1. *Size of the Georgian cigarette market.*

The Georgian cigarette market will face a sudden shock in regard to the VAT implementation regardless of which model is analyzed. The VAT implementation will increase cigarette retail price by about 20% on average. If we assume a price elasticity of about -0.35, a typical rate for cigarettes, a 20% hike in retail price translates to about a 7% decline in quantity sold. For a 7.3 billion piece market, the drop is roughly about 500 million pieces.

Therefore, for the forecast in which the Georgian government will continue with its slated changes to the cigarette excise tax structure, the market falls to 6.8 billion pieces in 2004 and gradually settles at 6.65 billion pieces for the 2005-07 period. For the forecast involving TMA's recommendations, the market holds steady at 7.3 billion pieces in 2004, but then drops (by the same percentage) to 6.8 billion pieces in 2005 and gradually settles at 6.65 billion pieces for the 2006-07 period.

Market Size (Billions of Pieces)	2003	2004	2005	2006	2007
Georgian government's current policy	7.3	6.8	6.65	6.65	6.65

2. *Percentage of imported cigarettes in the total market.*

The percentage of imports in the total market will remain at 50% for all years. We are not changing this variable as it is unclear in what direction it will change when the new cigarette excise tax policies are introduced.

3. *The percentage of legal cigarette imports as a part of total cigarette imports.*

Beginning this year, the Excise Tax Inspectorate's Enforcement Group will begin its work and should achieve some degree of success, particularly concerning domestic cigarette makers. However, the implementation of the VAT come July 1st will only exacerbate the illegal cigarette market in Georgia. TMA projects that the percentage of illegal imports of total imports will grow at a small rate, curtailed by the Enforcement Group's actions. By giving cigarette importers an extra year to better curtail their distribution flows to Georgia as well waiting for Russia and the Ukraine to increase their own cigarette excise taxes, the Enforcement Group will have the backing to perform more effectively and significantly reduce illegal imports in the long term. Will all illegal activity disappear? No, but it could be reduced by more than half over the next five years.

Legal imports as a % of total imports	2003	2004	2005	2006	2007
Georgian government's current policy	40%	38%	36%	34%	32%

4. *Percentage of legal domestically-produced cigarettes as a part of total domestically-produced cigarettes.*

Similarly to what was explained in (3), only to a greater degree, the year-long wait will give both local cigarette makers and the Excise Tax Inspectorate's Enforcement Group the time needed to effectively implement "honest" business.

Legal domestic as a % of total domestic Georgian government's current policy	2003	2004	2005	2006	2007
	66.7%	64%	62%	60%	58%

5. *Breakdown of illegally-sold cigarette imports.*

Similarly to what was explained in (3), only to a greater degree, the year-long wait will give both foreign cigarette makers and the Excise Tax Inspectorate's Enforcement Group the time needed to effectively implement "honest" business. The Enforcement Group will be much more efficient at seizing counterfeit cigarettes and stamps. However, cigarette smuggling over country borders not protected by the central government will remain a problem until political stability is achieved in these regions. We do not see stability for these regions in the short term and therefore must assume that illegal activity will continue for the next several years.

Type of Illegal Imports	2003	2004	2005	2006	2007
Border Smuggling	25%	40%	50%	60%	64%
Counterfeit Cigarettes and Stamps	35%	30%	25%	20%	18%
Counterfeit Stamps	40%	30%	25%	20%	18%

6. *Breakdown of illegally-sold domestically-produced cigarettes.*

Similarly to what was explained in (5), only to a greater degree, the year-long wait will give both local cigarette makers and the Excise Tax Inspectorate's Enforcement Group the time needed to effectively implement "honest" business. The Enforcement Group will be much more efficient at seizing counterfeit cigarettes and stamps. However, the barter issue will remain a problem until political stability is achieved in these regions. We do not see stability for these regions in the short term and therefore must assume that illegal activity will continue for the next several years.

Type of Illegal Imports	2003	2004	2005	2006	2007
Counterfeit Stamps	40%	25%	20%	17.5%	15%
Re-Used Stamps	40%	25%	20%	17.5%	15%
Barter System	20%	50%	60%	65%	70%

(e) *Forecast Results*

Please refer to Appendix B for the tax revenue and leakage figures by year for the 2003-07 period that were simulated with our model. A brief tableau of the results is below.

ESTIMATED TAX REVENUE AND LEAKAGE FOR THE GEORGIAN GOVERNMENT
(Figures are in millions of lari)

	2003	2004	2005	2006	2007
Excise Tax Revenue	39.2	41.4	40.8	38.9	37.1
VAT Revenue	5.0	21.8	36.7	35.1	33.5
Banderole Revenue		2.6	2.4	2.3	2.2
TOTAL TAX REVENUE	44.2	65.8	79.9	76.4	72.8
Excise Tax Leakage	45.0	49.5	50.2	53.3	55.2
VAT Leakage	4.8	24.1	43.2	45.9	47.5
Banderole Leakage		2.5	2.5	2.6	2.7
TOTAL TAX LEAKAGE	49.8	76.2	95.9	101.8	105.4

6. TMA's Recommendations on Action Plan

6.1 TMA Key Recommendations

Based on a complete analysis of all the data that was gathered, TMA has made a series of recommendations in government fiscal policy and legislation that it believes will achieve the mission's main objective, to increase excise tax revenues for the Georgian government without negatively affecting the competitive forces within the tobacco industry sector.

The first three recommendations were taken from TMA's Top 3 Recommendation report that was issued on May 15, 2004. After receiving further feedback from several key participants, slight changes have been made since the May 15th report.

Within each key recommendation are smaller recommendation relating to that topic.

6.1.1 TMA Recommendation # 1:

Introduce licensing requirements for cigarette importers, manufacturers, and distributors

TMA recommends that all cigarette importers, domestic cigarette manufacturers and cigarette distributors, as well as all delivery sellers, defined to mean all corporations or companies who transport or move tobacco products from one location to another, are to pay a nominal fee (30 lari per year) for a license to do business.

As learned from the April 20th stakeholders meeting, cigarette importers and manufacturers acquire permission (at no fee) to do business in Georgia. Other than completing the proper forms, anyone can purchase cigarette excise tax stamps. No official investigation is taken with regard to the legitimacy of specific stamp buyers including reviewing their past financial status and related business activity. Although the Excise Tax Inspectorate has noted that there are a limited number of stamp buyers in the Georgian market, an effort must be made to legitimize this. The government needs to regain control of this market and licensing is one important way.

The use of licenses provides several things: they identify the players in a market, they give the government the right to rescind a license and therefore have greater control in a market. Although the license fee is small, the fact that the Excise Tax Inspectorate would now know who has an import, manufacturing or wholesale license limits the chance of their excise tax stamps falling into the wrong hands and provides the identification needed within the track and trace system to numerically identify who has what product when.

Retailers should apply for a permit (at no fee) that would be an ID card with a retailer number. This identifies each retailer, while at the same time, aids the tax enforcement department discover illegal product or stamps identifying specific retailers within the track and trace system and making them "official."

6.1.2 TMA Recommendation # 2:

Modify several laws concerning the Georgian cigarette market

During the April 20th stakeholders meeting and in meetings held by TMA separately with principal stakeholders, it was evident that several major changes need to be made to the legal system to ensure better compliance by the tobacco industry's stakeholders. Nothing breeds disdain for the legal system as much as unnecessary and inconsistent laws that one must disobey to remain in business.

TMA recommends the following changes to Georgia's legal system:

- (a) For the law "On Approval of Regulations on Procedure of Registration, Distribution, and Control of Excise Stamps in Georgia," (Order No. 189 of the Finance Minister of Georgia - March 25, 2004), Article 3, No. 3 states:

"The damaged excise stamps are not subject to return."

TMA recommends that this order be reversed, provided that stamp purchasers are held to a higher standard to ensure that no reproduction or other misuse of stamps takes place. Most countries have laws which include provisions concerning the physical return of damaged tax stamps provided authentication of such stamps takes place. Since the Georgian excise stamp is placed inside the polypropylene around the cigarette pack, damaged stamps both in the sheet cutting process and during cigarette packing is normal, albeit predictable. Therefore, a "damage norm" policy could be established whereby stamp buyers could receive up to 0.5% of the total cost of the original payment that stamp buyers can get back if they return the damaged stamps and the Excise Tax Inspectorate determines that the returned damaged stamps are legitimate and that their numbers are not within the track and trace system other than at stage one e.g., having been sold to a given manufacturer.

Since it is unlikely that any legitimate manufacturer will exceed this sum, all returns can be made. On this point, the nominal cost of the stamp itself should be considered a cost of doing business for the government and should be included in the value of the stamp itself. The July 1, 2005 adjustment in taxes should include this value.

- (b) *TMA recommends* that penalties for distributors or retailers who possess, sell or offer to sell counterfeit cigarette packs or cigarette packs with counterfeit stamps must be established provided that the new track and trace enforcement mechanism provides these individuals with the means to determine what is legitimate from what is counterfeit. This premise is quite simple. The Excise Tax Inspectorate's Enforcement Group must have the backing of the law so violators know that handling unstamped or wrongly stamped packs has severe consequences.

The minimum amount that a person is in violation would be 1 illegal cigarette pack (20 pieces).

1st violation: 2,000 lari fine and the confiscation of their total inventory

2nd violation: 2-5 years in jail

These penalties are similar to those in Armenia.

- (c) The elimination of "irrational" or "conflicting" laws dealing with tobacco products.

Irrational laws such as the one which demands that a retailer have at least 50% of its employees disabled needs to be removed from the books. Laws that are completely opposite from each other that were put into effect at different times must be identified and corrected with industry input¹.

¹ TMA proposes that as a second phase of this project it be given a full copy of the entire Georgian Tobacco Tax Law in English with the aim of eliminating such inconsistencies and placing Georgia more in line with EU

6.1.3 TMA Recommendation # 3:

The Creation of a Data Analytical Center

One of the major disappointments in TMA's effort to collect data concerning the Georgia cigarette market was the absence of data from the central government.

The existence of a data analytical center, which would collect data from excise tax stamp sales, customs imports and exports, and other taxation and microeconomic data sources, is vital for the central government. The more the government understands its markets, the better equipped they will be to make fiscal decisions needed to keep tax revenues flowing and the market competitive.

6.1.4 TMA Recommendation # 4:

The Creation of an Effective Track and Trace Data Reconciliation System

Create an effective track and trace data reconciliation system to accurately track product flows from manufacturer and importer through to retail sales. Such a system includes the following:

1. Stamp design to include encrypted information in a 2d barcode including the unique serialized, but not sequential, number that defines the specific cigarette package;
2. Accurate and real-time tracking of these numbers through the system through the creation of highly secure database;
3. Scanning of the barcode through to retail with uploads of data to the database;
4. Querying of the database at retail by authorized enforcement agents;
5. Generation of exception reports when data reconciliation does NOT occur e.g., the same number appears twice in the system or a given number does not appear at all.

6.1.5 TMA Recommendation # 5:

Modify the Georgian cigarette excise tax structure

Please refer to Section 4.1 for the current cigarette excise tax structure.

Concerning Georgia's cigarette excise tax structure, *TMA recommends* the following:

(a) The scheduled separation of VAT from the excise tax rate should be delayed until July 1, 2005. If the Ministry pursues an extra VAT payment on July 1, 2004, it will immediately increase cigarette import retail prices by (0.24 - 0.40) lari per pack and domestically-produced cigarette retail prices by (0.10 - 0.20) lari per pack. With the larger price differential between legally sold cigarettes and the illegally-stamped or counterfeit cigarettes, the illegal market will grow (in terms of its percentage of the market) and it will prove to be more profitable (per pack sold) for those involved in the illegal market's activities. Increasing the profitability of the contraband business should not be a result of Georgia's fiscal policy even if doing so short-term means that the Ministry can raise additional revenue, which we believe would be the case given the inelasticity of consumption and the estimated substitution rates for contraband product over legal product.

tobacco tax policy where such would not negatively impact existing stakeholders. Input from stakeholders would be required as well.

We argue, however, that while excise tax/VAT revenue will significantly rise in the short term, it will not be enough to justify the loss in competitiveness in the tobacco market. To pursue this short-term increase is to forego the much needed longer term change in the economy towards one that has less corruption, more transparency and an improved climate for fair competition.

(b) TMA also recommends that the Excise Tax Inspectorate should no longer accept VAT offset payments to be applied for excise tax stamps². In other words, to ensure a clear audit trail within the track and trace system recommended, excise tax stamps must be directly and solely purchased, with no exceptions such as providing rebates for the payment of other taxes, including those on exported or allegedly exported products. This situation was described by Mr. Kakha Damenia at the April 20th tobacco stakeholders meeting.

The only concern with this recommendation is that the elimination of the VAT offset payments may impede export incentives. TMA is uncertain as to whether this impediment is greater than the amount of excise tax revenue that is lost.

(c) An Import Duty/VAT offset payment, however, should be applied to all raw materials that are imported and used to produce cigarettes domestically. Domestic cigarette producers that import their raw materials are faced with a double VAT taxation. First, the raw materials faced a VAT at import, and second the finished product cigarettes have a VAT tax at the point of sale. If local cigarette makers can prove (by their documentation) that their raw materials used for their production process were imported, they should receive a credit towards the back-end VAT payment.

(d) A phase-in of a harmonized excise tax schedule, defining the import share and separating the two. By harmonizing (or equalizing) excise tax rates between imported and domestic products, there would no need for multiple types of tax stamps, which improves enforcement efforts. With the VAT payment being taken out of the excise tax stamp, why cannot the import duty payment be taken out also? If customs officials can be trusted collecting import duty payments for almost all other consumer products, why should tobacco products (or for that matter, alcoholic products) be treated differently? By separating these collections, additional data reconciliation can be done in the track and trace system, and, perhaps most importantly, more corrupt officials would need to be brought into the process to effect the tax evasion, at least on imports. Furthermore, such a separation is necessary for EU entry and is standard WTO practice.

After analyzing the tariff rates of countries surrounding the Republic of Georgia, TMA recommends the following import duty payment for cigarettes that should go into effect on July 1, 2005:

Filtered cigarettes:	7 lari/1,000 pieces (0.14 lari/pack of 20)
Non-Filtered cigarettes:	3.5 lari/1,000 pieces (0.06 lari/pack of 20)

The above import duty payment is slightly higher than the 3 euro/1,000 piece rate that is currently collected in Russia, the Ukraine, Armenia and Moldova. Azerbaijan would still have a much lower import duty rate (US\$ 0.50/1,000 pieces).

With the above import duty rate in place, TMA recommends the following change in Georgia's cigarette excise tax system on July 1, 2005:

² Domestic manufacturers who declare their output to be slated for export are eligible to receive their VAT payments back once the Finance Ministry certifies that the aforementioned output was indeed exported. Instead of receiving a direct payment or a future advance of their VAT payments, local cigarette makers use the VAT return as an advance on their next cigarette excise tax stamp purchase. We also understand that in some cases VAT credits are transferred between companies. All offsets should be stopped.

Imported filtered cigarettes	-	0.25 lari/pack of 20
Imported non-filtered cigarettes	-	0.10 lari/pack of 20

NOTE: These figures would not include the import duty payment or VAT.

Domestically-produced filtered cigarettes	-	0.25 lari/pack of 20
Domestically-produced non-filtered cigarettes	-	0.10 lari/pack of 20

NOTE: These figures would not include VAT.

NOTE: Both importers and domestic cigarette makers must pay a separate VAT of 20% beginning July 1, 2005.

The development of an effective enforcement process, inclusive of a data center to do track and trace reconciliation of data/product flows, is not a simplistic process. Much care needs to go into the design of appropriate tax stamps to ensure that the barcode definition in the recommended stamp enables track and trace, including the identification of who stamped the product, when it was stamped, when it was shipped, by whom and to which destination³.

The July 1, 2005 delay in the implementation of this recommended tariff and tax structure is to give the Excise Tax Inspectorate (as well as the Finance Ministry) the necessary time to correctly and adequately set up its enforcement staff to properly and efficiently monitor and regulate the legal movement of cigarettes through the manufacturing, import, wholesale and retail channels. The delay also sends a clear message to the legitimate industry that the government is prepared to work with honest business to ensure a level playing field.

By creating a fair, level playing field in the tobacco sector, the Finance Ministry must assure industry stakeholders that the only way to do business is the legal way and those found conducting business in an improper illegal way will be rapidly uncovered and face severe and immediate consequences regardless of the illicit activity whether it be a company creating and using counterfeit cigarette excise tax stamps or a customs official receiving illicit payments.

6.2 Forecasting The Georgia Cigarette Market: If TMA's Recommended Cigarette Excise Tax Policy is Implemented

Using the TMA-derived 2003 figures in Section 3.3 as a base as well as the Assumptions (a), (b) and (d) from Section 5.2, we will forecast and compare cigarette excise tax revenue and leakage for the Georgia cigarette market if the Georgian government implements TMA's recommended cigarette excise tax policy.

(a) Incorporating TMA's proposed changes into the current cigarette excise tax structure

TMA recommends that on July 1, 2005, the Georgian government should incorporate the following changes to the current cigarette excise tax structure:

1. Setting the import duty payment for imported filtered cigarettes at 7.00 lari/1,000 pieces.

³ De La Rue's ScanNet is one such system albeit an expensive one. TMA has developed a design for a comparable track and trace system to be used in California. More details will be provided in a separate report.

2. Setting the import duty payment for imported non-filtered cigarettes at 3.50 lari/1,000 pieces.
3. Decreasing the excise tax for imported filtered cigarettes from 20.00 lari/1,000 pieces to 12.50 lari/1,000 pieces.
4. Decreasing the excise tax for imported non-filtered cigarettes from 10.00 lari/1,000 pieces to 5.00 lari/1,000 pieces.
5. Increasing the excise tax for domestically-produced filtered cigarettes from 10.00 lari/1,000 pieces to 12.50 lari/1,000 pieces.
6. Increasing the excise tax for domestically-produced non-filtered cigarettes from 3.50 lari/1,000 pieces to 5.00 lari/1,000 pieces.
7. Introducing a separate VAT of 20% to all cigarette sales.

TMA's recommendation separates the import duty payment, the excise tax payment and the VAT payment from one another (See Section 6.1.5 for further details).

The VAT quantification figures would be the same as those described in Assumption (c) from Section 5.2. The VAT amounts would then be:

Imported filtered cigarettes	-	16.000 lari/1,000 pieces
Imported non-filtered cigarettes	-	12.000 lari/1,000 pieces
Domestically-produced filtered cigarettes	-	10.500 lari/1,000 pieces
Domestically-produced non-filtered cigarettes	-	7.000 lari/1,000 pieces

Therefore, the new tax structure on July 1, 2005 would look like this:

1. Import Duty - Filtered cigarettes	-	7.000 lari/1,000 pieces
2. Import Duty - Non-Filtered cigarettes	-	3.500 lari/1,000 pieces
3. Excise Tax - Filtered cigarettes - Imported	-	12.500 lari/1,000 pieces
4. Excise Tax - Non-filtered cigarettes - Imported	-	5.000 lari/1,000 pieces
5. Excise Tax - Filtered cigarettes - Domestic	-	12.500 lari/1,000 pieces
6. Excise Tax - Non-filtered cigarettes - Domestic	-	5.000 lari/1,000 pieces
7. VAT - Filtered cigarettes - Imported	-	16.000 lari/1,000 pieces
8. VAT - Non-filtered cigarettes - Imported	-	12.000 lari/1,000 pieces
9. VAT - Filtered cigarettes - Domestic	-	10.500 lari/1,000 pieces
10. VAT - Non-filtered cigarettes - Domestic	-	7.000 lari/1,000 pieces

Because the new tax structure is being implemented on July 1st, only half of the year's cigarette sales will be affected by the changes. The above rates would be effective for 2006-07 in terms of our calculations. The average tax structure for 2005 would be:

11. Import Duty - Filtered cigarettes	-	8.500 lari/1,000 pieces
12. Import Duty - Non-Filtered cigarettes	-	5.000 lari/1,000 pieces
13. Excise Tax - Filtered cigarettes - Imported	-	10.417 lari/1,000 pieces
14. Excise Tax - Non-filtered cigarettes - Imported	-	3.959 lari/1,000 pieces
15. Excise Tax - Filtered cigarettes - Domestic	-	11.250 lari/1,000 pieces
16. Excise Tax - Non-filtered cigarettes - Domestic	-	3.959 lari/1,000 pieces
17. VAT - Filtered cigarettes - Imported	-	8.834 lari/1,000 pieces
18. VAT - Non-filtered cigarettes - Imported	-	6.292 lari/1,000 pieces
19. VAT - Filtered cigarettes - Domestic	-	6.084 lari/1,000 pieces
20. VAT - Non-filtered cigarettes - Domestic	-	3.792 lari/1,000 pieces

(b) Other Assumptions

For explanations for each of these assumptions, please refer back to Section 5.2.

1. *Size of the Georgian cigarette market.*

Market Size (Billions of Pieces)	2003	2004	2005	2006	2007
TMA's recommended policy	7.3	7.3	6.8	6.65	6.65

2. *Percentage of imported cigarettes in the total market.*

The percentage of imports in the total market will remain at 50% for all years.

3. *The percentage of legal cigarette imports as a part of total cigarette imports.*

Legal imports as a % of total imports	2003	2004	2005	2006	2007
TMA's recommended policy	40%	45%	55%	65%	75%

4. *Percentage of legal domestically-produced cigarettes as a part of total domestically-produced cigarettes.*

Legal domestic as a % of total domestic	2003	2004	2005	2006	2007
TMA's recommended policy	66.7%	70%	75%	80%	85%

5. *Breakdown of illegally-sold cigarette imports.*

TMA is not differentiating these variables between the two different scenarios.

Type of Illegal Imports	2003	2004	2005	2006	2007
Border Smuggling	25%	40%	50%	60%	64%
Counterfeit Cigarettes & Stamps	35%	30%	25%	20%	18%
Counterfeit Stamps	40%	30%	25%	20%	18%

6. *Breakdown of illegally-sold domestically-produced cigarettes.*

TMA is not differentiating these variables between the two different scenarios.

Type of Illegal Imports	2003	2004	2005	2006	2007
Counterfeit Stamps	40%	25%	20%	17.5%	15%
Re-Used Stamps	40%	25%	20%	17.5%	15%
Barter System	20%	50%	60%	65%	70%

(c) **Forecast Results**

Please refer to Appendix B for the tax revenue and leakage figures by year for the 2003-07 period that were simulated with our model. A brief tableau of the results is below.

**ESTIMATED TAX REVENUE AND LEAKAGE FOR THE GEORGIAN GOVERNMENT IF
TMA'S RECOMMENDATIONS ARE IMPLEMENTED**
(Figures are in millions of lari)

	2003	2004	2005	2006	2007
Excise Tax Revenue	39.2	43.0	51.8	63.0	70.6
VAT Revenue	5.0	5.4	28.6	57.0	63.6
Banderole Revenue		3.1	3.3	3.6	4.0
TOTAL TAX REVENUE	44.2	51.6	83.8	123.6	138.2
Excise Tax Leakage	45.0	47.2	33.5	27.2	19.7
VAT Leakage	4.8	4.4	17.3	24.0	17.3
Banderole Leakage		2.3	1.8	1.4	1.0
TOTAL TAX LEAKAGE	49.8	47.9	52.6	52.6	38.0

**6.3 Comparing TMA's Recommended Policy to the Government's
Planned Changes to the Cigarette Excise Tax Structure**

First, we will combine the forecast results into one table shown below.

ESTIMATED TAX REVENUE AND LEAKAGE FOR THE GEORGIAN GOVERNMENT
(Figures in millions of lari; 2003 is base year)

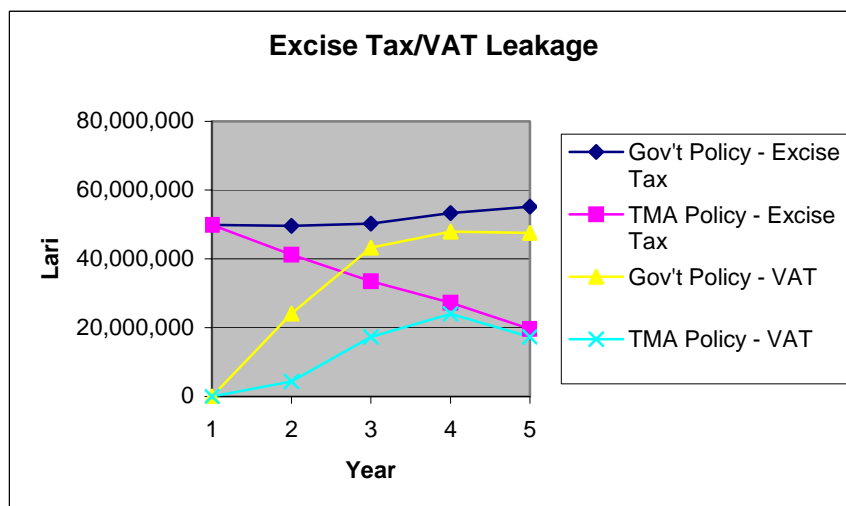
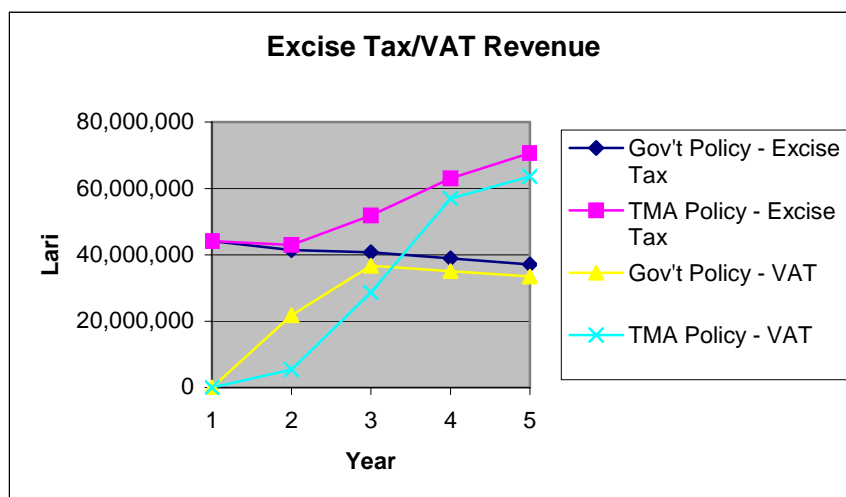
	2003	2004	2005	2006	2007
Excise Tax Revenue - Gov't	39.2	41.4	40.8	38.9	37.1
VAT Revenue - Gov't	5.0	21.8	36.7	35.1	33.5
Banderole Revenue - Gov't		2.6	2.4	2.3	2.2
TOTAL TAX REVENUE - Gov't	44.2	65.8	79.9	76.4	72.8
Excise Tax Revenue - TMA	39.2	43.0	51.8	63.0	70.6
VAT Revenue - TMA	5.0	5.4	28.6	57.0	63.6
Banderole Revenue - TMA		3.1	3.3	3.6	4.0
TOTAL TAX REVENUE - TMA	44.2	51.6	83.8	123.6	138.2
Excise Tax Leakage - Gov't	45.0	49.5	50.2	53.3	55.2
VAT Leakage - Gov't	4.8	24.1	43.2	45.9	47.5
Banderole Leakage - Gov't		2.5	2.5	2.6	2.7
TOTAL TAX LEAKAGE - Gov't	49.8	76.2	95.9	101.8	105.4
Excise Tax Leakage - TMA	45.0	47.2	33.5	27.2	19.7
VAT Leakage - TMA	4.8	4.4	17.3	24.0	17.3
Banderole Leakage - TMA		2.3	1.8	1.4	1.0
TOTAL TAX LEAKAGE - TMA	49.8	47.9	52.6	52.6	38.0

One glance at the data above and one can see that the Georgian government's current policy will collect more excise tax/VAT revenue in 2004 than TMA's recommended policy. That should be expected since the one-year delay that TMA is recommending before changing the nation's cigarette tax structure will keep VAT revenues at zero if the current excise tax revenue does not put aside any funds from the supposed VAT portion of the excise tax.

By separating excise tax and VAT in 2003, one can see that excise tax revenue does indeed increase for the government in 2004 due to the excise tax increase placed on domestically-produced cigarettes. The VAT revenue jumps to over 21.8 million lari in 2004, which is smaller than the 28.6 million lari figure that TMA predicts if its recommended tax policy is implemented in 2005. All of the government's gains, however, gradually dissipate as the higher cigarette prices keep the illegal cigarette sector healthy despite the stronger efforts of the Excise Tax Inspectorate's Enforcement Group. TMA's gains in excise tax revenue average about 15% for the years following the tax change implementation.

The leakage figures tell a more damaging story. With higher taxes, there is more room for leakage. TMA estimates that the amount of Excise tax/VAT/Banderole leakage will double from 2003's figure of almost 49.8 million lari to 2007's estimated figure of nearly 105.4 million lari if the Georgian government maintains its current course, despite stronger efforts of the Enforcement Group. Except for a small increase in 2005 when TMA's recommended policy is implemented, tax leakage decreases for each year, particularly as a percentage of the total potential tax revenue that the government could collect.

The following charts clearly show that the government's policy will gradually create a decrease in excise tax and VAT revenue over time, but a decrease in excise tax and VAT leakage (Yr1 = 2003...).



7. Conclusions

This report contains TMA's five recommendations for the Georgian Ministry of Finance to consider in its decision making process concerning the cigarette industry and are as follows:

1. Introduce licensing requirements for cigarette importers, manufacturers, and distributors
2. Modify several laws concerning the Georgian cigarette market
3. Create a Data Analytical Center
4. Create an Effective Track and Trace Data Reconciliation System
5. Modify the Georgian cigarette excise tax structure in the manner that TMA prescribes

This report was designed to solve the problem of increasing excise tax revenue and reducing excise tax leakage. Any and all of the solutions require the government to work in concert with the tobacco industry stakeholders. Strong, but fair guidelines are to be set by the government as participants in the industry are to follow these guidelines to the strictest letter of the law.

It should be observed at the outset that increasing tax revenues from the tobacco sector cannot be done short term without damaging competitiveness. Rather, to ensure a steady stream of growing tax revenues from tobacco, public policy first needs to address the elimination of corruption and the creation of more stable competitiveness in the tobacco market. Only by creating a more efficient and equitable tax policy can the Ministry of Finance be assured that both tax revenues and competitiveness will improve as the economy evolves. Furthermore, there are no quick fixes to achieve both revenue enhancement and improved competition. Both need to be addressed in tandem given that competition will be negatively impacted if the government attempts to raise revenues by increasing taxes in the short-term. Rather, the government needs to "invest" short-term, both through a deferral of tax hikes and through increased investments in physical enforcement as well as data collection – effectively a track and trace system – to ensure that tax increases in the future will not simply increase the profitability of selling contraband cigarettes, defined to mean both smuggled and counterfeit products.

4. ALCOHOLIC BEVERAGES

In the area of alcoholic beverages, REG support has consisted of facilitating the formation of a stakeholder working group. This group has prepared the following preliminary analysis.

The Georgian market of alcoholic beverages urgently requires improved regulation, monitoring, and enforcement to improve transparency of both local production and imported products. The initial challenge is to accurately estimate the actual volume of the market. Since available data differs among government units, one cannot rely on any single source, whether it is the Statistical Department or other institutions or agencies.

Actual annual consumption of spirits in Georgia is estimated at 15,000 tons. According to the data provided by Custom Department for 2000, there were 2,642 tons of spirits released in free circulation, or 18 percent of estimated real consumption (related government revenues amounted to GEL 497,400). Data for 2001 estimated consumption of 15,000 and 2,595 tons of spirits, or 17.3 percent of the actual consumption (related government revenues amounted to GEL 741,400).

Analysis of the official Form # 412, as well as the reconciliation of available data, suggest that the budget should receive approximately GEL 120 million from alcohol beverages in the form of VAT and excise taxes. In reality, Form # 412 only includes GEL 2,9 million in 2003 for wine and spirit production and GEL 1,5 million for beer. Thus, it appears that excise tax leakage from spirits (primarily vodka) is as high as GEL 81 million.⁴

Details of this calculation are as follows:

- Demand for spirits in Georgia is 2.0-2.5 thousand tons per month, or 24-30 thousand tons per annum (in liters: 27 thousand tons x 1.25 = 33,750,000 liters)
- 33,750,000 liters of spirits x 2.4 = 81,000,000 thousand liters of vodka.
- Excise tax per 1 liter is 1 GEL, so the budget should receive from vodka production 81,000,000 liters x 1 GEL = 81 million GEL

Likewise, VAT evasion is calculated as follows:

- 67.5 million GEL (cost of spirits) + 32.4 million GEL (expenses) + 81.0 million (excise) + 18.1 million (profitability 10 percent) = 199 million GEL x 20 percent = 39.8 million GEL.
- The budget should have received 39.8 million GEL as a VAT payment.
- Potential budget revenues from vodka supply (excise tax, VAT) are 81 + 39.8 = 120.8 million GEL (Quarterly = 30.2 million GEL)
- Consistent with Form #412, in the 1st quarter of 2004 the revenues comprised 1.6 million GEL or 5.3 percent of potential revenues (1st Quarter data for 2003 is 0.7 million GEL)

The stakeholders identified the following issues as proposed solutions:

⁴ Based on data from the Excisable Goods Monitoring Bureau of the former Ministry of Tax Revenues.

i) Unknown Size of the Georgian alcohol market

Because much of the Georgian economy is underground, it is both difficult and critical to measure the actual size of the market. In order to determine the volume of domestically produced as well as the volume of imported goods, additional research is required that combines known data regarding market size with assumptions and calculations that incorporates the habits of population including average per capita consumption.

ii) Absence of sufficient statistical database

No government agency involved with alcohol market regulation compiles sufficient reporting (for example, the Railway Department uses different codes from those that are used by Customs department, statistical information of Customs is not consistent with the information from border guards, etc.).

Solution: Create a centralized data reconciliation center that estimates the Georgian alcohol market size. In addition, all reporting formats of government agencies dealing with alcohol products should be unified within a single statistical format.

iii) Ineffective regulation of alcohol production by the state

The agency responsible for the regulation of alcohol market is “Samtrest”, which is not effective and does not regulate the market in practice. “Samtrest” was originally created (in Soviet times) as a union of wineries, and later elevated to a semi-regulatory function. There remain problems however with its independence, responsibilities and powers; Thus leaving the market with no effective regulation.

Solution: Form a new agency, that will have sole responsibility for the regulation of the market, standard settings, and compliance with the excise tax policy (under the Ministry of Finance), with proper legal framework.

iv) Excise tax leakage of alcohol production.

Excise tax leakage is the revenue lost by the central government from illegal activity, including a) the illegal use of counterfeit excise tax stamps on domestically manufactured alcohol, b) the illegal recycling of excise stamps on domestically produced alcohol; c) smuggling connected with the import of the alcohol goods

Solution: Strengthened administrative procedures and even criminal penalties for the violators. In order to improve customs procedures (import, export, transit, re-export, etc.), the Customs Department should implement a cargo tracing system on alcohol products.

Transit controls should be significantly improved. In cases of illegal conduct, the warranty amounts should be transferred to the budget before the transit movement is fully confirmed. Other penalties should remain in place.

APPENDIX A - OIL PRODUCTS

Importing products:

1. From which countries are petroleum products imported today in Georgia?

Products	Countries from where Georgia is importing today.
LPG	Russia, Turkmenistan, Kazakhstan, Azerbaijan
Gasoline	Azerbaijan, Turkmenistan, Greece, Bulgaria, Romania, Russia
Diesel	Azerbaijan, Turkmenistan, Russia
Jet Fuel	Azerbaijan
Kerosene	Azerbaijan
Mazut	Azerbaijan, Turkmenistan
Lube Oils	Azerbaijan, Russia, US, Europe, Greece

2. What % of import is coming from different regions into Georgia officially?

Products	Azerbaijan	Black Sea	Ossetia (trucking)	Russia (trucking)	Others
LPG	10%	0%		40% (includes from Ossetia)	40% (Kazakhstan) Turkmenistan 10%
Gasoline	75%	5% (Romania & Bulgaria)		6%	Turkmenistan-10%
Kazakhstan- 2%					
Greece- 2%					
Diesel	90%				Turkmenistan- 10%
Jet Fuel	100%				
Kerosene	100%				
Mazut	10%				Turkmenistan-90%
Lube Oils					

3. What % of import is coming from different regions into Georgia both on official and non-official basis?

Products	Azerbaijan	Black Sea	Ossetia (trucking)	Russia (trucking)	Others
LPG	20%/80%			20%/80%	80%/20% Kazakhstan
Gasoline	52%/48%		0/100%	50%/50%	100%/0% Greece
Diesel	20%/80%		0/100%	0%/100%	
Jet Fuel	100%/0%				
Kerosene	0%/100%				
Mazut	100%/0%				100%/0% Turkmenistan
Lube Oils					

One possible scenario of meeting annual gasoline demand of 600,000 and 400,000 tons in Georgia are as follows:

Sources	600,000 tons case		400,000 tons case	
	tons	%	tons	%
Black Sea legal	14,000	2%	14,000	4%
Black Sea smuggled	6,000	1%	4,000	1%
Azerbaijan Legal	240,000	40%	220,000	55%
Azerbaijan Smuggled train	60,000	10%	40,000	10%
Azerbaijan Red Bridge	120,000	20%	80,000	20%
Smuggled by declaring transit	120,000	20%	12,000	3%
Informal refineries	40,000	7%	30,000	8%

One possible scenario of meeting 360,000 tons and 250,000 tons of annual diesel demand in Georgia.

Sources	360,000 tons case		400,000 tons case	
	tons	%	tons	%
South Ossetia smuggled	90,000	25%	62,500	25%
Azerbaijan legal	54,000	15%	37,500	15%
Azerbaijan train smuggled	7,200	2%	5,000	2%
Azerbaijan Red Bridge	28,800	8%	20,000	8%
Smuggled by declaring transit	24,000	7%	7,500	3%
Informal refineries	126,000	35%	87,500	35%
Vat exempt	10,000	3%	10,000	4%
Vat exempt monetized	20,000	6%	20,000	8%

4. a. How many importers are involved in gasoline, diesel and LPG trade today?
- b. How many “real” importers are involved in importing petroleum products today?

Products	Total number of importers	“Real” importers
LPG	23 (3 large and 20 small)	5
Gasoline	143	20
Diesel	132	20

5. Do importers require any license/permit to import petroleum products?

Not required. They just need to be legal entities with the tax registration. Often these are registered in the name of dummy people and also at non-existing addresses.

6. Do we have information on the dealers in exporting countries who trade petroleum products into Georgia? Are they the government owned or private refineries exporting those products? Or are there independent traders?

Azerbaijan is one of the important countries supplying petroleum products to Georgia. Petroleum traders have the possibility of buying products at fixed price which is independent of platts. If the fixed price is close to or considerably less than platts price, then these traders have every incentive to smuggle products by trucking it over the Red Bridge. Because of sheer logistics, this kind of smuggling may not be on large scale.

7. How are the import prices (from the Black Sea, Azerbaijan,) related to Mediterranean prices? What are the costs involved in importing? What items can be reduced by streamlining the importing process?

Georgia should be able to buy petroleum products from Azerbaijan at prices discounted from platts. However in practice this is not happening. Since there is considerable amount of surplus of petroleum products in this region, it should be possible to buy products discounted from Med. Platts. For example, in 2002, Georgian railways transported through Georgia 0.9 million tons of gasoline, 1.7 million tons of diesel and 1.7 million tons of fuel oil. We need to understand the reasons for the failure on the part of Georgian traders to buy products at attractive prices from Azerbaijan.

Terminaling and transporting to final consumers:**8. How many petroleum product terminals are there in Georgia?**

30 operating.

9. Do they need license to operate these terminals?

They do need licenses to construct and operate.

10. How do they transfer products from railway yards to terminals?

Generally every terminal possesses own railway yard.

11. Do they use railway yards officially or unofficially as product terminals?

Railway yards are used unofficially by traders for storage.

12. How do products are transferred to final consumers? (e.g service stations)

By the tank cars.

Refining:**13. How many informal refineries are there today?**

On some official reporting basis, there are 17 registered refineries. However, former Finance Minister stated that there are 41 informal refineries. But this is rejected by some informed people. It is possible that a refinery may be registered under the name of many and it is considered as many for tax purpose. This is given as one of the reasons for the overestimation. But this does not make sense.

14. Where do they get their supplies of crude oil and blending components?

Crude oil is imported officially from Russia, Azerbaijan, and Turkmenistan to be processed in these refineries. In such a case there is no good economics of processing the crude oil unless they cheat the government on tax payment and customers on quality. Some of them are processing locally produced crude oil. They may get discount as much as \$8 per barrel on paper. But in reality it may be only \$6 per barrel since they have to pay cash payment of \$2 per barrel according to one owner of the tea-kettle refinery. Such refineries while processing locally produced crude oil though selling naphtha and mazut at highly discounted price can make good profit. In addition if they also avoid paying taxes, then they earn very attractive profit. We were also told that Azerbaijan does not allow the export of crude oil into Georgia. And Georgian importers bring crude illegally as waste products. Ministry of

Environment told us that they do not permit the import of waste products. But by paying bribes, they are able to bring such waste products.

15. What products do they produce?

They produce mostly naphtha, diesel and mazut. There is one refinery in Rustavi near Azoti plant to process such naphtha into high octane gasoline. Because of tax code, refinery has to pay taxes on naphtha though it is to be processed further and reclaim the excess paid amount later. This can work as a disincentive to the refinery since reclaiming taxes paid is not easy and may force the refinery to take recourse to illegal basis. There are different versions of how naphtha and mazut is disposed by these refineries. According to some sources, naphtha is blended into gasoline which will result in getting good price for naphtha. Of course this will lower octane rating of gasoline which is not checked by any inspector any way. Mazut is added to diesel in some small quantities which lower the quality of diesel. In short some of the products of these refineries are sold in illegal ways.

16. What rules and regulations control their operations today?

Till the adoption of New Refinery Law which establishes the State Agency for Regulation of Oil and Gas resources of Georgia as one-stop shop, there were many agencies involved in approving the construction of refineries. However in reality, in recent years, there were no rules and regulations to control the operations of these refineries. SAROGR now adopted some rules to regulate these refineries.

According to Ministry of Environment, though they were in charge of giving permits to the construction of refineries, they do not have the rights to close the illegal refineries nor do they have the rights to close those legal refineries which do not meet the requirements. To close any illegal refinery besides them, two more agencies are involved. And it is difficult to get the approval from all of them. As a result in reality, these illegal refineries are free to operate. This was the case before establishing the State Agency. Now with the establishment, SAROGR has the full power to cancel their licenses. However the Finance Ministry can also suspend their operations if they can prove that taxes to owed to the government have not been paid.

17. What economic incentives do they have for their existence?

If they have access to locally produced oil which they can buy at discounted price, then there is good economic incentive even if naphtha and mazut is sold at discounted prices. However there is no incentive to process if they have to pay world market related prices.

The back of the envelope type calculations show that a refinery with 100 tons per day capacity working at 25% capacity and processing Georgian crude oil can make annual profit of \$0.2 million and if they are able to avoid taxes by paying bribes, they can earn as much as \$0.6 million. In other words, they can recover their investment in less than a year even operating at 25% capacity. If they have to pay world crude oil prices, then they will not be economical if they have to pay all the taxes. However if they can avoid taxes, then they will be economical. But it will take longer time to recover their investment.

18. How do these refineries affect those petroleum companies who want to operate by the rules?

Since most of these refineries sell lower grade products and that too at discounted prices by avoiding taxes, legal traders will find it difficult to compete with them.

19. What is the economics of blending of products?

There is no great economics unless one resorts to avoiding taxes and also sells sub-standard goods.

20. How do these informal refineries market their products?

There seem to be a ready market for the products of these refineries. Wholesale marketers who have mastered the art of bribing officials which is not all that hard in Georgia contact these informal refineries to buy their products. Thus there is no problem in selling the sub-standard products.

Marketing:

21. What are the different ways final consumers are buying gasoline and diesel in Georgia?

80% through filling stations and the rest 20% illegally (canister).

What % of consumers are buying gasoline from service stations in urban areas and rural areas?

80% in urban areas and 60% in rural areas.

What % of consumers are buying diesel from service stations in urban and rural areas?

40% in urban areas and 5% in rural areas.

22. Is there a need to get licenses from any government agency to own and operate a service station?

Yes. These are given by local agencies. There appears to be elaborate system to approve the construction of the service stations.

23. Do service stations submit any reports to the government agency on their sales? What reporting requirement is there today?

Reporting to the tax department through submitting their tax payment declarations. But these reports are highly suspect. They also have to report to Excise Tax Inspectorate.

24. What kind of laws and regulations control owning and operating service stations today in Georgia?

Tax code, Presidential Decree 434 of 1999 and law on standardization.

25. How many stations are there in Tbilisi? Outside Tbilisi in the rest of the country?

The registered stations in Tbilisi are 350 and the rest of Georgia is 850. In total there are 1200. At the end of 2002, there were about 250 operating stations in Tbilisi and 300 outside Tbilisi.

26. Who are the leading marketers in Georgia today and what is their market share based on official sales and non-official sales for gasoline?

Companies	# of stations		Market Share			
	Tbilisi	Rest of Georgia	Official sales basis		Total sales basis	
			Tbilisi	Rest of Georgia	Tbilisi	Rest of Georgia
Canargo						
Transexpress						
Eko Georgia						
Iberia						
Lukoil						

By one estimate they have the following market share for Tbilisi:

Trans express Ltd	5%
EkoGeorgia	4%
Canrago	9%
Lukoil	3%
Ibercompany	5%
Others	74%

27. Who are the leading marketers in Georgia today and what is their market share based on official sales and non-official sales for diesel?

Companies	# of stations		Market Share			
	Tbilisi	Rest of Georgia	Official sales basis		Total sales basis	
			Tbilisi	Rest of Georgia	Tbilisi	Rest of Georgia
Canargo						
Transexpress						
Eko Georgia						
Iberia						
Lukoil						

28. What are the different ways consumers are buying diesel?

Only a small percentage of diesel is sold through service stations and also reputed companies. Most of diesel is sold through informal channels.

29. What percentage of diesel is sold at service stations?

About 10% of diesel is sold through official or formal channels.

Testing labs:

30. How many petroleum testing labs are there in Georgia?

By one source it is six and by another source it is ten.

31. How many of these labs are accredited by Standard regulation unit?

Looks like six seem to have been credited by Standard regulation unit.

32. What is the competence of these labs in assessing the quality of products sold in Georgia?

Some of them do have necessary equipment and expertise to assess the minimum quality requirements of petroleum products.

33. What is the credibility of certificates issued by these labs?

Very little. It is possible to get certificate even without producing samples.

34. What system is there in Georgia to ensure that products sold in Georgia meet the regulations? (at importing point, refining centers, blending centers and marketing centers)

At importing points there is a requirement to assess the quality of products. Since importers take the sample themselves to the lab and get a certificate, it has no credibility. At refineries, at present there is just no system of getting samples and testing them since they are operating as a cottage industry with very little supervision. Now it is left to the SAROGR to develop and implement new rules to regulate these refineries. At blending centers, there is no system to assess the quality. At service stations, though Standard regulation unit is in charge, it cannot take samples at random. It has to get prior approval from the judge based on some proof. Standard regulation unit has submitted the needed changes to make laws more effective to ensure the quality of petroleum products sold at service stations to the parliament and it has yet to approve them.

35. Why has the system of ensuring quality of products sold in Georgia has failed?

There are some loop holes in the present code in ensuring quality. There needs a total cultural change at Standard regulation unit. Because of the present structure and management philosophy of Standard regulation unit, it is unlikely that the current situation will improve even if the Parliament approves all the legal reforms recommended by it.

Under the Ministry of Fuel and Energy, there is a Supervising Division for Inspection of Quality with about 300 employees. They are also supposed to monitor the fuel quality. However today because of limited funds, they are unable to carry out their function. This division today is concerned mostly with power sector monitoring and have decided to ignore petroleum sector both because of limited funds, lack of expertise and access to their own testing laboratory.

36. What is the optimum way to fix the system without introducing a lot of government bureaucracy or another layer to collect bribes?

If we can find a third party like AmCham or credible NGO to own and operate a testing lab, then only we can hope to improve quality of products sold in Georgia. In addition, we need to adapt changes recommended by Standard regulation unit to impose higher penalty for violating quality standards and to make it easy to take samples from service stations.

General subjects and management information system:

37. What system does Georgia have to collect information on consumption/import of gasoline and diesel and other petroleum products?

There is no central agency to collect information on petroleum products. Neither is there a government agency which has the responsibility to make an estimation of consumption of petroleum products. The Department of Statistics collects and reports on the consumption of petroleum products based on customs and tax department. But this as all know is not a very good source. In fact the one of the top officials of the department readily agreed that their reports are not credible. When we met with the people working on these reports, we found out that they do not have any expertise in this field. No governmental agency seems to have demanded from them to generate credible information on energy sector in general and petroleum sector in particular. Though Ministry of Fuels and Energy promised them some funds to improve their capability, no funds were given. They are waiting for assistance to improve their operations.

According to Presidential decree NO 434, Excise monitoring bureau was set up to monitor gasoline and diesel consumption. But this has responsibility to report on Tbilisi only. Even here it can do so only based on legal imports which as we know does not account for all the consumption.

As a result it is impossible to get any credible information on gasoline and diesel consumption for Georgia.

38. How many government agencies are today involved in controlling and monitoring taxes in petroleum sector?

- 1.** Ministry of Finance
 - a. Customs Department
 - b. Tax Department
 - c. Excise tax Inspectorate
 - d. Financial Police
- 2.** State Agency for Regulation of oil and gas resources of Georgia
- 3.** Ministry of Environment
- 4.** Standard regulation unit
- 5.** Anti monopoly
- 6.** Border Guards
- 7.** Ministry of Interior
- 8.** Ministry of State Security

APPENDIX B - TOBACCO PRODUCTS

Estimated Tax Revenue and Leakage (2003)	Mn. Of Pieces	Tax Revenue Lari	Tax Leakage Lari	Tax Revenue US\$	Tax Leakage US\$
Total Market	7,300.00	44,165,000	49,822,500	22,082,500	24,911,250
Imports	3,650.00				
Domestically-Produced	3,650.00				
Legal Imports (Filter)	1,314.00	26,280,00		13,140,000	
Legal Imports (Non-Filter)	146.00	1,460,000		730,000	
Illegal Imports	2,190.00				
Illegal Imports – Border Sales (Filter)	492.75		9,855,000		4,927,500
Illegal Imports – Border Sales (Non-Filter)	54.75		547,500		273,750
Illegal Imports – Counterfeit C&S (Filter)	689.85		13,797,000		6,898,500
Illegal Imports – Counterfeit C&S (Non-Filter)	76.65		766,500		383,250
Illegal Imports – Counterfeit Stamps (Filter)	788.40		15,768,000		7,884,000
Illegal Imports – Counterfeit Stamps (Non-Filter)	87.60		876,000		438,000
Legal Domestically-Produced (Filter)	1,216.67	12,166,667		6,083,333	
Legal Domestically-Produced (Non-Filter)	1,216.67	4,258,333		2,129,167	
Illegal Domestically-Produced	1,216.67				
Illegal Domestically-Produced – Counterfeit (Filter)	243.33		2,433,333		1,216,667
Illegal Domestically-Produced–Counterfeit (Non-Filter)	243.33		851,667		425,833
Illegal Domestically-Produced- Stamp Re-Use (Filter)	243.33		2,433,333		1,216,667
Illegal Domestically-Produced-Stamp Re-Use(Non-Filter)	243.33		851,667		425,833
Illegal Domestically-Produced-Barter System (Filter)	121.67		1,216,667		608,333

Illegal Domestically-Produced-Barter System (Non-Filter)	121.67		425,833		212,917
Cigarette Excise Taxes (per million pieces)	Rate				
Excise Tax – Domestically-produced filtered cigarettes	10,000.00				
Excise Tax – Domestically-produced non- filtered cigarettes	3,500.00				
Excise Tax – Imported filtered cigarettes	20,000.00				
Excise Tax – Imported non- filtered cigarettes	10,000.00				
		Lari	Lari	US\$	US\$
Cigarette Excise Tax Breakdown (per million pieces)	Rate	Revenue	Leakage	Revenue	Leakage
Import Duty – Filtered Cigarettes	10,000.00	13,140,000	19,710,000	6,570,000	9,855,000
Import Duty – Non-Filtered Cigarettes	6,500.00	949,000	1,423,500	474,500	711,750
Excise Tax – Imported filtered cigarettes	8,333.33	10,949,996	16,424,993	5,474,998	8,212,497
Excise Tax – Imported non- filtered cigarettes	2,916.67	425,834	638,751	212,917	319,375
Excise Tax – Domestic filtered cigarettes	8,333.33	10,138,885	5,069,442	5,069,442	2,534,721
Excise Tax – Domestic non- filtered cigarettes	2,916.67	3,548,615	1,774,308	1,774,308	887,154
VAT – Imported filtered cigarettes	1,666.67	2,190,004	3,285,007	1,095,002	1,642,503
VAT – Imported non-filtered cigarettes	583.33	85,166	127,749	42,583	63,875
VAT - Domestic filtered cigarettes	1,666.67	2,027,782	1,013,891	1,013,891	506,945
VAT - Domestic non-filtered cigarettes	583.33	709,718	354,859	354,859	177,430
TOTAL		44,165,000	49,822,500	22,082,500	24,911,250
Import Duty Total		14,089,000	21,133,500	7,044,500	10,566,750
Excise Tax/VAT Total		30,076,000	28,689,000	15,038,000	14,344,500
Excise Tax Total		25,063,329	23,907,494	12,531,665	11,953,747
VAT Total		5,012,671	4,781,506	2,506,335	2,390,753
Illegal Domestically-Produced-Stamp Re-Use (Filter)	153.00				

Illegal Domestically-Produced-Stamp Re-Use (Non-Filter)	153.00				
Illegal Domestically-Produced-Barter System (Filter)	306.00				
Illegal Domestically-Produced-Barter System (Non-Filter)	306.00				
		Lari	Lari	US\$	US\$
Cigarette Excise Tax Breakdown (per million pieces)	Rate	Revenue	Leakage	Revenue	Leakage
Import Duty- Filtered cigarettes	10,000.00	11,628,000	18,972,000	5,814,000	9,486,000
Import Duty- Non-Filtered cigarettes	6,500.00	839,800	1,370,200	419,900	685,100
Excise Tax- Imported filtered cigarettes	10,000.00	11,628,000	18,972,000	5,814,00	9,486,00
Excise Tax- Imported non-filtered cigarettes	3,500/00	452,200	737,800	226,100	368,900
Excise Tax –Domestic filtered cigarettes	11,250.00	12,240,000	6,885,000	6,120,000	3,442,500
Excise Tax –Domestic non-filtered cigarettes	4,250.00	4,624,000	2,601,000	2,312,000	1,300,500
VAT –Imported filtered cigarettes	8,834.00	10,272,175	16,759,865	5,136,088	8,379,932
VAT –Imported non-filtered cigarettes	6,292.00	812,926	1,326,354	406,463	663,177
VAT –Domestic filtered cigarettes	6,084.00	6,619,392	3,723,408	3,309,696	1,861,704
VAT –Domestic non- filtered cigarettes	3,792.00	4,125,696	2,320,704	2,062,848	1,160,352
Banderole (Cost of Stamps)	750.00	2,601,000	2,499,000	1,300,500	1,249,500
TOTAL		65,843,190	76,167,330	32,921,595	38,083,665
Import Duty Total		12,467,800	20,342,200	6,233,900	10,171,100
Excise Tax Total		28,944,200	29,195,800	14,472,100	14,597,900
VAT Total		21,830,190	24,130,330	10,915,095	12,065,165
Banderole Total		2,601,000	2,499,000	1,300,500	1,249,500

2005 A – Estimated Tax Revenue & Leakage		Tax Revenue	Tax Leakage	Tax Revenue	Tax Leakage
If Georgia Government Maintains Current Policies	Mn. Of Pieces	Lari	Lari	US\$	US\$
Total Market	6,650.00				
Imports	3,325.00				
Domestically-Produced	3,325.00				
Legal Imports (Filter)	1,077.30				
Legal Imports (Non-Filter)	119.70				
Illegal Imports	2,061.50				
Illegal Imports – Border Sales (Filter)	927.68				
Illegal Imports – Border Sales (Non-Filter)	103.08				
Illegal Imports – Counterfeit C&S (Filter)	463.84				
Illegal Imports – Counterfeit C&S (Non-Filter)	51.54				
Illegal Imports – Counterfeit Stamps (Filter)	463.84				
Illegal Imports – Counterfeit Stamps (Non-Filter)	51.54				
Legal Domestically-Produced (Filter)	1,030.75				
Legal Domestically-Produced (Non-Filter)	1,030.75				
Illegal Domestically-Produced	1,263.50				
Illegal Domestically-Produced –Counterfeit (Filter)	126.35				
Illegal Domestically-Produced -Counterfeit (Non-Filter)	126.35				
Illegal Domestically-Produced – Stamp Re-Use (Filter)	126.35				
Illegal Domestically-Produced - Stamp Re-Use (Non-Filter)	126.35				
Illegal Domestically-Produced –Barter System (Filter)	379.05				
Illegal Domestically-Produced –Barter System (Non-Filter)	379.05				

Cigarette Excise Tax Breakdown (per million pieces)	Rate	Lari Revenue	Lari Leakage	US\$ Revenue	US\$ Leakage
Import Duty – Filtered Cigarettes	10,000.00	10,773,000	18,553,500	5,386,500	9,276,750
Import Duty – Non-Filtered Cigarettes	6,500.00	778,050	1,339,975	389,025	669,988
Excise Tax- Imported filtered cigarettes	10,000.00	10,773,000	18,553,500	5,386,500	9,276,750
Excise Tax- Imported non-filtered cigarettes	3,500.00	418,950	721,525	209,475	360,763
Excise Tax –Domestic filtered cigarettes	12,500.00	12,884,375	7,896,875	6,442,188	3,948,438
Excise Tax –Domestic non-filtered cigarettes	5,000.00	5,153,750	3,158,750	2,576,875	1,579,375
VAT –Imported filtered cigarettes	16,000.00	17,236,800	29,685,600	8,618,400	14,842,800
VAT –Imported non-filtered cigarettes	12,000.00	1,436,400	2,473,800	718,200	1,236,900
VAT –Domestic filtered cigarettes	10,500.00	10,822,875	6,633,375	5,411,438	3,316,688
VAT –Domestic non- filtered cigarettes	7,000.00	7,215,250	4,422,250	3,607,625	2,211,125
Banderol (Cost of Stamps)	750.00	2,443,875	2,493,750	1,221,938	1,246,875
TOTAL		79,936,325	95,932,900	39,968,163	47,966,450
Import Duty Total		11,551,050	19,893,475	5,775,525	9,946,738
Excise Tax Total		29,230,075	30,330,650	14,615,038	15,165,325
VAT Total		36,711,325	43,215,025	18,355,663	21,607,513
Banderole Total		2,443,875	2,493,750	1,221,938	1,246,875

2006 A – Estimated Tax Revenue & Leakage		Tax Revenue	Tax Leakage	Tax Revenue	Tax Leakage
If Georgia Government Maintains Current Policies	Mn. Of Pieces	Lari	Lari	US\$	US\$
Total Market	6,650.00				
Imports	3,325.00				
Domestic Produced	3,325.00				
Legal Imports (Filter)	1,017.45				
Legal Imports (Non-Filter)	113.05				
Illegal Imports	2,194.50				
Illegal Imports – Border Sales (Filter)	1,185.03				
Illegal Imports – Border Sales (Non-Filter)	131.67				
Illegal Imports – Counterfeit C&S (Filter)	395.01				
Illegal Imports – Counterfeit C&S (Non-Filter)	43.89				
Illegal Imports – Counterfeit Stamps (Filter)	395.01				
Illegal Imports – Counterfeit Stamps (Non-Filter)	43.89				
Legal Domestically-Produced (Filter)	997.50				
Legal Domestically-Produced (Non-Filter)	997.50				
Illegal Domestically-Produced	1,330.00				
Illegal Domestically-Produced –Counterfeit (Filter)	116.38				
Illegal Domestically-Produced -Counterfeit (Non-Filter)	116.38				
Illegal Domestically-Produced – Stamp Re-Use (Filter)	116.38				
Illegal Domestically-Produced - Stamp Re-Use (Non-Filter)	116.38				
Illegal Domestically-Produced –Barter System (Filter)	432.25				
Illegal Domestically-Produced –Barter System (Non-Filter)	432.25				

Cigarette Excise Tax Breakdown (per million pieces)	Rate	Lari Revenue	Lari Leakage	US\$ Revenue	US\$ Leakage
Import Duty – Filtered Cigarettes	10,000.00	10,174,500	19,750,500	5,087,250	9,875,250
Import Duty – Non-Filtered Cigarettes	6,500.00	734,825	1,426,425	367,413	713,213
Excise Tax- Imported filtered cigarettes	10,000.00	10,174,500	19,750,500	5,087,250	9,875,250
Excise Tax- Imported non-filtered cigarettes	3,500.00	395,675	768,075	197,838	384,038
Excise Tax –Domestic filtered cigarettes	12,5000.00	12,468,750	8,312,500	6,234,375	4,156,250
Excise Tax –Domestic non-filtered cigarettes	5,000.00	4,987,500	3,325,000	2,493,750	1,662,500
VAT –Imported filtered cigarettes	16,000.00	16,279,200	31,600,800	8,139,600	15,800,400
VAT –Imported non-filtered cigarettes	12,000.00	1,356,600	2,633,400	678,300	1,316,700
VAT –Domestic filtered cigarettes	10,500.00	10,473,750	6,982,500	5,236,875	3,491,250
VAT –Domestic non- filtered cigarettes	7,000.00	6,982,500	4,655,000	3,491,250	2,327,500
Banderol (Cost of Stamps)	750.00	2,344,125	2,643,375	1,172,063	1,321,688
TOTAL		76,371,925	101,848,075	38,185,963	50,924,038
Import Duty Total		10,909,325	21,176,925	5,454,663	10,588,463
Excise Tax Total		28,026,425	32,156,075	14,013,213	16,078,038
VAT Total		35,092,050	45,871,700	17,546,025	22,935,850
Banderole Total		2,344,125	2,643,375	1,172,063	1,321,688

2007 A – Estimated Tax Revenue & Leakage		Tax Revenue	Tax Leakage	Tax Revenue	Tax Leakage
If Georgia Government Maintains Current Policies	Mn. Of Pieces	Lari	Lari	US\$	US\$
Total Market	6,650.00				
Imports	3,325.00				
Domestic Produced	3,325.00				
Legal Imports (Filter)	957.60				
Legal Imports (Non-Filter)	106.40				
Illegal Imports	2,261.00				
Illegal Imports – Border Sales (Filter)	1,302.34				
Illegal Imports – Border Sales (Non-Filter)	144.70				
Illegal Imports – Counterfeit C&S (Filter)	366.28				
Illegal Imports – Counterfeit C&S (Non-Filter)	40.70				
Illegal Imports – Counterfeit Stamps (Filter)	366.28				
Illegal Imports – Counterfeit Stamps (Non-Filter)	40.70				
Legal Domestically-Produced (Filter)	964.25				
Legal Domestically-Produced (Non-Filter)	964.25				
Illegal Domestically-Produced	1,396.50				
Illegal Domestically-Produced –Counterfeit (Filter)	104.74				
Illegal Domestically-Produced -Counterfeit (Non-Filter)	104.74				
Illegal Domestically-Produced – Stamp Re-Use (Filter)	104.74				
Illegal Domestically-Produced - Stamp Re-Use (Non-Filter)	104.74				
Illegal Domestically-Produced –Barter System (Filter)	488.78				
Illegal Domestically-Produced –Barter System (Non-Filter)	488.78				

Cigarette Excise Tax Breakdown (per million pieces)	Rate	Lari Revenue	Lari Leakage	US\$ Revenue	US\$ Leakage
Import Duty – Filtered Cigarettes	10,000.00	9,576,000	20,349,000	4,788,000	10,174,500
Import Duty – Non-Filtered Cigarettes	6,500.00	691,600	1,469,650	345,800	734,825
Excise Tax- Imported filtered cigarettes	10,000.00	9,576,000	20,349,000	4,788,000	10,174,500
Excise Tax- Imported non-filtered cigarettes	3,500.00	372,400	791,350	186,200	395,675
Excise Tax –Domestic filtered cigarettes	12,500.00	12,053,125	8,728,125	6,026,563	4,364,063

2004 B – Estimated Tax Revenue & Leakage		Tax Revenue	Tax Leakage	Tax Revenue	Tax Leakage
If Georgia Government Follows TMA Recommendations	Mn. Of Pieces	Lari	Lari	US\$	US\$
Total Market	7,300.00				
Imports	3,650.00				
Domestic Produced	3,650.00				
Legal Imports (Filter)	1,478.25				
Legal Imports (Non-Filter)	164.25				
Illegal Imports	2,007.50				
Illegal Imports – Border Sales (Filter)	722.70				
Illegal Imports - Border Sales (Non-Filter)	80.30				
Illegal Imports – Counterfeit C&S (Filter)	542.03				
Illegal Imports– Counterfeit C&S (Non-Filter)	60.23				
Illegal Imports– Counterfeit Stamps Re-Use (Filter)	542.03				
Illegal Imports– Counterfeit Stamps Re-use (Non-Filter)	60.23				
Legal Domestically-Produced (Filter)	1,277.50				
Legal Domestically-Produced (Non-Filter)	1,277.50				
Illegal Domestically-Produced	1,095.00				
Illegal Domestically-Produced –Counterfeit (Filter)	136.88				
Illegal Domestically-Produced -Counterfeit (Non-Filter)	136.88				
Illegal Domestically-Produced – Stamp Re-Use (Filter)	136.88				
Illegal Domestically-Produced - Stamp Re-Use (Non-Filter)	136.88				
Illegal Domestically-Produced –Barter System (Filter)	273.75				
Illegal Domestically-Produced –Barter System (Non-Filter)	273.75				

Cigarette Excise Tax Breakdown (per million pieces)	Rate	Lari Revenue	Lari Leakage	US\$ Revenue	US\$ Leakage
Import Duty – Filtered Cigarettes	10,000.00	14,782,500	18,067,500	7,391,250	9,033,750
Import Duty – Non-Filtered Cigarettes	6,500.00	1,067,625	1,304,875	533,813	652,438
Excise Tax- Imported filtered cigarettes	8,333.33	12,318,745	15,056,244	6,159,373	7,528,122
Excise Tax- Imported non-filtered cigarettes	2,916.67	479,063	585,522	239,532	292,761
Excise Tax –Domestic filtered cigarettes	8,333.33	10,645,829	4,562,498	5,322,915	2,281,249
Excise Tax –Domestic non-filtered cigarettes	2,916.67	3,726,046	1,596,877	1,863,023	798,438
VAT –Imported filtered cigarettes	1,666.67	2,463,755	3,011,256	1,231,877	1,505,628
VAT –Imported non-filtered cigarettes	583.33	95,812	117,03	47,906	58,552
VAT –Domestic filtered cigarettes	1,666.67	2,129,171	912,502	1,064,585	456,251
VAT –Domestic non- filtered cigarettes	583.33	745,204	319,373	372,602	159,687
Banderol (Cost of Stamps)	750.00	3,148,125	2,326,875	1,574,063	1,163,438
TOTAL		51,601,875	47,860,625	25,800,938	23,930,313
Import Duty Total		15,850,125	19,372,375	7,925,063	9,686,188
Excise Tax Total		27,169,683	21,801,140	13,584,842	10,900,570
VAT Total		5,433,942	4,360,235	2,716,971	2,180,117
Banderole Total		3,148,125	2,326,875	1,574,063	1,163,438
Excise Tax –Domestic non-filtered cigarettes	5,000.00	4,821,250	3,491,250	2,410,625	1,745,625
VAT –Imported filtered cigarettes	16,000.00	15,321,600	32,558,400	7,660,800	16,279,200
VAT –Imported non-filtered cigarettes	12,000.00	1,276,800	2,713,200	638,400	1,356,600
VAT –Domestic filtered cigarettes	10,500.00	10,124,625	7,331,625	5,062,313	3,665,813
VAT –Domestic non- filtered cigarettes	7,000.00	6,749,750	4,887,750	3,374,875	2,443,875
Banderole (Cost of Stamps)	750.00	2,244,375	2,743,125	1,122,188	1,371,563
TOTAL		72,807,525	105,412,475	36,403,763	52,706,238

Import Duty Total		10,267,600	21,818,650	5,133,800	10,909,325
Excise Tax Total		26,822,775	33,359,725	13,411,388	16,679,863
VAT Total		33,472,775	47,490,975	16,736,388	23,745,488
Banderole Total		2,244,375	2,743,125	1,122,188	1,371,563

2005 B – Estimated Tax Revenue & Leakage		Tax Revenue	Tax Leakage	Tax Revenue	Tax Leakage
If Georgia Government Follows TMA Recommendations	Mn. Of Pieces	Lari	Lari	US\$	US\$
(Transition Year)					
Total Market	6, 800.00				
Imports	3, 400.00				
Domestic Produced	3, 400.00				
Legal Imports (Filter)	1, 683.00				
Legal Imports (Non-Filter)	187.00				
Illegal Imports	1, 530.00				
Illegal Imports – Border Sales (Filter)	688.50				
Illegal Imports - Border Sales (Non-Filter)	76.50				
Illegal Imports – Counterfeit C&S (Filter)	344.25				
Illegal Imports– Counterfeit C&S (Non-Filter)	38.25				
Illegal Imports– Counterfeit Stamps Re-Use (Filter)	344.25				
Illegal Imports– Counterfeit Stamps Re-use (Non-Filter)	38.25				
Legal Domestically-Produced (Filter)	1, 275.00				
Legal Domestically-Produced (Non-Filter)	1,275.00				
Illegal Domestically-Produced	850.00				
Illegal Domestically-Produced –Counterfeit (Filter)	85.00				
Illegal Domestically-Produced -Counterfeit (Non-Filter)	85.00				
Illegal Domestically-Produced – Stamp Re-Use (Filter)	85.00				
Illegal Domestically-Produced - Stamp Re-Use (Non-Filter)	85.00				
Illegal Domestically-Produced –Barter System (Filter)	255.00				
Illegal Domestically-Produced –Barter System (Non-Filter)	255.00				

Cigarette Excise Tax Breakdown (per million pieces)	Rate	Lari Revenue	Lari Leakage	US\$ Revenue	US\$ Leakage
Import Duty – Filtered Cigarettes	8, 500.00	14, 305, 500	11, 704, 500	7, 152, 750	5, 852, 250
Import Duty – Non-Filtered Cigarettes	5, 000.00	935, 000	765, 000	467, 500	382, 500
Excise Tax- Imported filtered cigarettes	10, 416.50	17, 530, 970	14, 343, 521	8, 765, 485	7, 171, 760
Excise Tax- Imported non-filtered cigarettes	3, 958. 50	740, 240	605, 651	370, 120	302, 825
Excise Tax –Domestic filtered cigarettes	10, 416.50	13, 281, 038	4, 427, 013	6, 640, 519	2, 213, 506
Excise Tax –Domestic non-filtered cigarettes	3, 958.50	5, 047, 088	1, 682, 363	2, 523, 544	841, 181
VAT –Imported filtered cigarettes	8, 833.50	14, 866, 781	12, 163, 730	7, 433, 390	6, 081, 865
VAT –Imported non-filtered cigarettes	6, 291.50	1, 176, 511	962, 600	588, 255	481, 300
VAT –Domestic filtered cigarettes	6, 083.50	7, 756, 463	2, 585, 488	3, 878, 231	1, 292, 744
VAT –Domestic non- filtered cigarettes	3, 791.50	4, 834, 163	1, 611, 388	2, 417, 081	805, 694
Banderol (Cost of Stamps)	750.00	3, 315,000	1, 785, 000	1, 657, 500	892, 500
TOTAL		83, 788, 750	52, 636, 250	41, 894, 375	26, 318, 125
Import Duty Total		15, 240, 500	12, 469, 500	7, 620, 250	6, 234, 750
Excise Tax Total		36, 599, 334	21, 058, 546	18, 299, 667	10, 529, 273
VAT Total		28, 633, 916	17, 323, 204	14, 316, 958	8, 661, 602
Banderole Total		3, 315, 000	1, 785, 000	1, 657, 500	892, 500

2006 B – Estimated Tax Revenue & Leakage if Georgia Government follows TMA Recommendations	Mn. of Pieces	Tax Revenue Lari	Tax Leakage Lari	Tax revenue US\$	Tax Leakage US\$
Total Market	6, 650.00				
Imports	3, 325.00				
Domestically Produced	3, 325.00				
Legal Imports (filter)	1, 945. 13				
Legal Imports (non-filter)	216.13				
Illegal Imports	1, 163.75				
Illegal Imports – Border Sales (filter)	628.43				
Illegal Imports - Border Sales (non-filter)	69.83				
Illegal Imports – Counterfeit C&S (filter)	209.48				
Illegal Imports – Counterfeit C & S (non-filter)	23.28				
Illegal Imports – Counterfeit Stamps (filter)	209.48				
Illegal Imports – Counterfeit Stamps (non-filter)	23.28				
Legal - Domestically Produced (filter)	1, 330.00				
Legal – Domestically Produced (non-filter)	1, 330.00				
Illegal – Domestically Produced	665.00				
Illegal Domestically Produced – Counterfeit (filter)	58.19				
Illegal – domestically Produced – Counterfeit (non-filter)	58.19				
Illegal – domestically Produced – Stamps Re-Use (filter)	58.19				
Illegal- Domestically Produced – Stamps Re-Use (non-filter)	58.19				
Illegal – Domestically Produced – Barter System (filter)	216.13				
Illegal – Domestically Produced – Barter System (non-filter)	216. 13				

Cigarette excise Tax Breakdown (per million pieces)	Rate	Lari Revenue	Lari Leakage	US\$ Revenue	US\$ Leakage
Import duty – Filtered Cigarettes	7, 000.00	13, 615, 875	7, 331, 625	6, 807, 938	3, 665, 813
Import duty – Non-Filtered Cigarettes	3, 500.00	756, 438	407, 313	378, 219	203, 656
Excise Tax – Imported Filtered cigarettes	12, 500.00	24, 314, 063	13, 092, 188	12, 157, 031	6, 546, 094
Excise Tax – Imported Non-Filtered cigarettes	5, 000.00	1, 080, 625	581, 875	540, 313	290, 938
Excise Tax – Domestically Filtered Cigarettes	12, 500.00	16, 625, 000	4, 156, 250	8,312, 500	2, 078,125
Excise Tax – Domestically Non-Filtered Cigarettes	5, 000.00	6, 650, 000	1, 662, 500	3, 325, 000	831, 250
VAT – Imported Filter Cigarettes	16,000.00	31,122,000	16,758,000	15,561,000	8,379,000
VAT – Imported Non-Filter Cigarettes	12,000.00	2, 593, 500	1,396,500	1,296,750	698,250
VAT- Domestic Filtered Cigarettes	10, 500.00	13, 965, 000	3, 491, 250	6, 982, 500	1, 745, 625
VAT- Domestic Non- Filtered Cigarettes	7, 000.00	9,310,000	2,327, 500	4, 655, 000	1,163,750
Banderole (cost of stamps)	750.00	3, 615, 938	1, 371, 563	1, 807, 969	685, 781
TOTAL		123, 648, 438	52, 576, 563	61, 824, 219	26, 288, 281
Import Duty Total		14, 372, 313	7, 738, 938	7, 186,156	3, 869, 469
Excise Tax Total		48, 669, 688	19, 492, 813	24, 334, 844	9, 746, 406
VAT Total		56, 990, 500	23, 973, 250	28, 495, 250	11, 986, 525
Banderole Total		3, 615, 938	1, 371, 563	1, 807, 969	685, 781

2007 B – Estimated Tax Revenue & Leakage if Georgia Government Follows TMA Recommendations	Mn. Of pieces	Tax Revenue Lari	Tax Leakage Lari	Tax Revenue US\$	Tax Leakage US\$
Total Market	6, 650.00				
Imports	3, 325.00				
Domestically Produced	3, 325.00				
Legal Imports (Filter)	2, 244.38				
Legal Imports (Non-Filter)	249.38				
Illegal Imports	831.25				
Illegal Imports – Border Sales (Filter)	478.00				
Illegal Imports – Border Sales (Non-filter)	53.20				
Illegal Imports – Counterfeit C&S (Filter)	134.66				
Illegal Imports – Counterfeit C&S (Non-Filter)	14.96				
Illegal Imports – Counterfeit Stamps (Filter)	134.66				
Illegal Imports – Counterfeit Stamps (Non-Filter)	14.96				
Legal – Domestically Produced (filter)	1, 413.13				
Legal Domestically Produced (Non-filter)	1, 413.13				
Illegal Domestically Produced	498.75				
Illegal Domestically Produced Counterfeit (Filter)	37.41				
Illegal Domestically Produced Counterfeit (Non-Filter)	37.41				
Illegal Domestically Produced Stamps Re-Use (Non-Filter)	37.41				
Illegal Domestically Produced Barter System (Filter)	174.56				
Illegal Domestically Produced Barter System (Non-Filter)	174.56				

Cigarette excise Tax Breakdown (per million pieces)	Rate	Lari Revenue	Lari Leakage	US\$ Revenue	US\$ Leakage
Import duty – Filtered Cigarettes	7,000.00	15,710,625	5,236,875	7,855,313	2,618,438
Import duty – Non-Filtered Cigarettes	3,500.00	872,813	290,938	436,406	145,469
Excise Tax – Imported Filtered cigarettes	12,500.00	28,054,688	9,351,563	14,027,344	4,675,781
Excise Tax – Imported Non-Filtered cigarettes	5,000.00	1,246,875	415,625	623,438	207,813
Excise Tax – Domestically Filtered Cigarettes	12,500.00	17,664,063	3,117,188	8,832,031	1,558,594
Excise Tax – Domestically Non-Filtered Cigarettes	5,000.00	7,065,625	1,246,875	3,532,813	623,438
VAT – Imported Filter Cigarettes	16,000.00	35,910,000	11,970,000	17,955,000	5,985,000
VAT – Imported Non-Filter Cigarettes	12,000.00	2,992,500	997,500	1,496,250	498,750
VAT- Domestic Filtered Cigarettes	10,500.00	14,837,813	2,618,438	7,418,906	1,309,219
VAT- Domestic Non- Filtered Cigarettes	7,000.00	9,891,875	1,745,625	4,945,938	872,813
Banderole (cost of stamps)	750.00	3,990,000	997,500	1,995,000	498,750
TOTAL		138,236,875	37,988,125	69,118,438	18,994,063
Import Duty Total		16,583,438	5,527,813	8,291,719	2,763,906
Excise Tax Total		54,031,250	14,131,250	27,015,625	7,065,625
VAT Total		63,632,188	17,331,563	31,816,094	8,665,781
Banderole Total		3,990,000	997,500	1,995,000	498,750

Assumptions	2003	2004	2005	2006	2007
Current Gov't Policy					
Market Size (billions of pieces)	7.3	6.8	6.65	6.65	6.65
Imports as a % of the Total Market	60%	60%	60%	60%	60%
% of Legal - Imports	40%	38%	36%	34%	32%
% of Legal – Domestic Market	66.7%	64%	62%	60%	58%
Illegal Imports - % of Border Sale	25%	40%	50%	60%	64%
Illegal Imports - % of Counterfeit Cigs. & Stamps	35%	30%	25%	20%	18%
Illegal Imports - % of Counterfeit Stamps	40%	30%	25%	20%	18%
Illegal Domestically-Produced - % of Counterfeit	40%	25%	20%	17.5%	15%
Illegal Domestically-Produced - % of Stamps Re-Use	40%	25%	20%	17.5%	15%
Illegal Domestically-Produced - % of Barter System	20%	50%	60%	65%	70%
TMA Recommendation Program	2003	2004	2005	2006	2007
Market Size (billions of pieces)	7.3	7.3	6.8	6.65	6.65
Imports as a % of the Total Market	60%	60%	60%	60%	60%
% of Legal - Imports	40%	45%	55%	65%	75%
% of Legal – Domestic Market	66.7%	70%	75%	80%	85%
Illegal Imports - % of Border Sale	25%	40%	50%	60%	64%
Illegal Imports - % of Counterfeit Cigs. & Stamps	35%	30%	25%	20%	18%
Illegal Imports - % of Counterfeit Stamps	40%	30%	25%	20%	18%
Illegal Domestically-Produced - % of Counterfeit	40%	25%	20%	17.5%	15%
Illegal Domestically-Produced - % of Stamps Re-Use	40%	25%	20%	17.5%	15%
Illegal Domestically-Produced - % of Barter System	20%	50%	60%	65%	70%

ESTIMATED TAX REVENUE AND LEAKAGE									
(Lari)	2003	2004		2005		2006		2007	
		Gov't	TMA	Gov't	TMA	Gov't	TMA	Gov't	TMA
Import Duty	14,089,000	12,467,800	15,850,125	11,551,050	15,240,500	10,909,325	14,372,313	10,267,600	16,583,438
Excise Tax	25,063,329	28,944,200	27,169,683	29,230,075	36,599,334	28,026,425	48,669,688	26,822,775	54,031,250
VAT	5,012,671	21,830,190	5,433,942	36,711,325	28,633,916	35,092,050	56,990,500	33,472,775	63,632,188
Banderol		2,601,000	3,148,125	2,443,875	3,315,000	2,344,125	3,615,938	2,244,375	3,990,000
Total Tax Revenue	44,165,000	65,843,190	51,601,875	79,936,325	83,788,750	76,371,925	123,648,439	72,807,525	138,236,876
Import Duty Leakage	21,133,500	20,342,200	19,372,375	19,893,475	12,469,500	21,176,925	7,738,938	21,818,650	5,527,813
Excise Tax Leakage	23,907,494	29,195,800	21,801,140	30,330,650	21,058,546	32,156,075	19,492,813	33,359,725	14,131,250
VAT Leakage	4,781,506	24,130,330	4,360,235	43,215,025	17,323,204	45,871,700	23,973,250	47,490,975	17,331,563
Banderol Leakage		2,499,000	2,326,875	2,493,750	1,785,000	2,643,375	1,371,563	2,743,125	997,500
Total Tax Leakage	49,822,500	76,167,330	47,860,625	95,932,900	52,636,250	101,848,075	52,576,564	105,412,475	37,988,126

APPENDIX C - REG STAKEHOLDER GROUP PARTICIPANTS

PETROLEUM

NAME	ORGANIZATION
Vasiko Khorava	Canargo Standard Oil
Kakhaber Damenia	Excise Taxpayers Inspectorate
David Ioseliani	Tbilisi City Assembly
Giorgi Nikoladze	Tbilisi City Assembly
David Tsekvava	Financial Police
Joe Downey	USAID
Koba Amirejibi	"Nukoil" LLC
Sandro Liluashvili	"Oil Land" LLC
Lasha Koridze	"Ganoil" LLC
Gia Kotrikadze	Association "NIA"
Irakli Pirtskhalaishvili	"Georgiana" LLC
Anzor Chlikadze	"Maroil" LLC
Marlen Tatenashvili	"Maroil" LLC
Konstantite Jorjikia	"Georgiana" LLC
David Galegashvili	Tax Department
Vano Nakaidze	AmCham
David Kezerashvili	Financial Police
Soso Pkhakadze	"Kanargo Standard Oil"
Gia Khukhashvili	Railway Supervisory Board
Irakli Dabrundashvili	BP Partner "AviaFuelService"
George Esakia	Budget Office of the Parliament
Shalva Zhordania	Customs Department
Nugzar Tsaguria	Customs Department
Amy Denman	AmCham
George Abulashvili	AmCham
Kote Zhghenti	Georgian Standards
Soso Kumaritov	Employer's Association of Georgia
Panagiotes Economou	EKO Georgia LLC
David Minimoshvili	"Kosmo" LLC
Edisher Mamaladze	"Canargo Standard Oil"
Vasil Kharava	"Canargo Standard Oil"
Mikhail Alikhanashvili	Ibercompany Holding
David Inauri	"Ksani" LLC
Zaal Iakobidze	"Zemodi" LLC
Anzor Klikadze	"Baroili" LLC
Marlen Tatelashvili	"Baroili" LLC
Louisa Khitarishvili	GEGI
Bhamy Shenoy	GEGI
Robert Krause	GEGI
Maka Gureshidze	GEGI
Andro Kotetishvili	GEGI
David Koguashvili	GEGI

TOBACCO

NAME	ORGANIZATION
Ramaz Klimiashvili	European Chamber of Commerce (ECC)
Zura Beruashvili	“Samgori 1994”
Kakhaber Damenia	Excise Taxpayers Inspectorate
Soso Kumaritov	Employer’s Association
Saba Sarishvili	Georgian Business Confederation (GBC)
Tamuna Shvangiradze	GBC
Zurab Unapkoshvili	JTI
Temur Kvernadze	GCC
Irina Nikuradze	British American Tobacco
Giorgi Abashidze	Employer’s Association
Zurab Margishvili	British American Tobacco
Zaza Kanchaveli	“Maridi” LLC
Beso Apkaidze	“Maridi” LLC
Davit Khutsishvili	Production & Network Limited
David Koguashvili	GEGI
Farrel Delman	GEGI
Maka Gureshidze	GEGI
Andro Kotetishvili	GEGI

ALCOHOL

NAME	ORGANIZATION
Shota Makatsaria	Georgian Chamber of Commerce
Konstantine Zhghenti	Employer's Association
Vano Didberidze	Employer's Association
Giorgi Mshvidobadze	"GWS"
Levan Paghava	"Vaziani"
Zurab Narkheuli	"Tbilgvino" supervisory board
Irakli Tabatadze	"Bagrationi 1882"
Irakli Bekauri	"Askaneli Brothers"
Avtandil Khurashvili	"Askaneli Brothers"
Mamuka Svanidze	"GMT Wine Company"
Mikheil Ghotvadze	"Taro Investment Inc."
Inga Gogiashvili	"Manavi" Wine factory
Giorgi Gogoladze	"Racha Wine"
David Dugladze	"Gomi" supervisory board
Giorgi Kratsashvili	"Triumph"
Parnavaz Gvelesiani	"Sameba"
Nino Gabunia	"Sameba"
Dimitri Kupradze	"Triumph 1887"
Bukhuti Badzaghua	"Khazbegi"
Aleko Bolkvadze	"Kasteli"
Nino Chkhartishvili	"Shumi"
Levan Davitashvili	"Vazi"
Robert Krause	GEGI
David Koguashvili	GEGI